University of Alberta

Insurance Fraud: A Legal and Sociological Approach

by

Jorge Cabrera ©

A thesis submitted to the Faculty of Graduate Studies and Research in partial fulfilment of the requirements for the degree of *Master of Laws*.

Faculty of Law

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The undersigned certify that they have read, and recommend to the Faculty of Graduate Studies and Research for acceptance, a thesis entitled *Insurance Fraud: a Legal and Sociological Approach* submitted by *Jorge Cabrera* in partial fulfilment of the requirements for the degree of *Master of Laws*.

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Abstract

The criminal justice system is in crisis. Levels of crime against property are increasing astronomically all over the world, but the law and judgements from the judiciary are not committed to the postulates of the principles of prevention, deterrence and rehabilitation, and the law itself is, for many crimes, unhelpful. As a consequence, the criminal justice system is tacitly giving the opportunity to other conflict-solving mechanisms to enter into society.

The decriminalization of the conduct in countries such as the United States, Canada and England is the subject of this thesis.

This thesis describes the concept of insurance fraud, its approaches and types. It also explains the sociological approach to the phenomenon, trying to present another important perspective of the problem, the criminological one. As well, the legal aspects of the phenomenon in Canada, England and the United States are presented. Finally, this thesis proposes a new model of understanding the phenomenon of insurance fraud and presents the idea of decriminalization of the conduct for better management of this social deviance.

Dedication

To mi father and mother, for being always the constants and most wonderful recipients of everything I have done in my life. Because everything we do is in vane if there is nobody that can receive it honestly and disinterested. For their love and support when circumstances during these years have been difficult.

To my love, Juanita. For her company, for her words, for her mornings full of kisses, love and coffee and the nights with hugs and hot soup for soul.

A mi papa y mi mama, por haber sido siempre los constantes y mas maravillosos destinatarios de todo lo que he hecho en esta vida. Por que no vale la pena lograr cosas en la vida si detras no hay quien pueda disfrutar de ellas honesta y desinteresadamente. Por su amor y apoyo cuando las circusntancias que han rodeado esto anos no han sido las mas amables.

A mi amor, Juanita. Por la compania, por sus palabras, por las mananas con besos y cafe, y las noches con abrazos y sopa caliente para el alma. Por ser la mejor amiga, el mejor ser humano de todos.

Preface

Since 1995, when I conducted research on insurance fraud for the Colombian Insurers Federation (FASECOLDA), I have understood that Colombian insurers were not dealing with insurance fraud in the proper way. After months of thinking about the problem and interviewing an important sample of the Colombian insurance industry's Chief Executive Officers, I confirmed my first perception: the insurance industry in Colombia was entirely vulnerable to insurance fraud and, moreover, the industry's lack of knowledge was rampant. To go overseas and to study the problem from another richer and more fruitful perspective became a necessity.

Moreover, all the information that I could gather during years of research and the work done with the industry in Colombia, raised issues which are at the heart of this research: Where is the criminal justice system localized in relation to insurance fraud? What role is it playing in controlling the problem? and overall, Why are the steps followed by insurance companies seen to be part of the state?

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Introduction

> **Because jurisprudence and sociology share a concern with normative phenomena, either field can profit by examining the conceptual schemes of the other.**
>
> **Jack P. Gibbs[1]**

> **It is evident, then, that a discussion of the relation of the several social sciences to law, in any of the mechanisms of that term, is timely and significant. It is especially significant for jurisprudence as indicating the line of synthesis of the subjects, competing for the name "law", even as we must distinguish them, in the science of law as men understand it today.**
>
> **Roscoe Pound[2]**

This thesis develops an idea using a real example: it is an attempt to propose a change in the legal system by extracting a rule from the system itself. This thesis presents the idea of the decriminalization of a type of conduct – insurance fraud.

What I shall seek to establish is that insurance fraud is best dealt with through private means, without the mediation of the State and its criminal law processes. Furthermore, private means of dealing with insurance fraud provide a model for the "de-criminalization" of many types of conduct currently labelled and prosecuted as "criminal."

My argument shall have the following steps:

---

[1] J.P. Gibbs, "The Sociology of Law and Normative Phenomenon" (1966) 31 American Sociology Review at 315.

[2] "R. Pound, Foreword" to C. Huntington, *Law and the Social Sciences* (New York: Rothman Reprints, 1969) at 2.

In Chapter One, I shall review the nature of insurance fraud and statistics concerning its prevalence. Using a descriptive and common language, I will deal with the meaning of insurance fraud, and the perspective of offender and the victim, in an attempt to help the reader to understand the legal analysis and the model of decriminalization I propose in this thesis.

In Chapters Two, Three and Four I shall review legal responses to insurance fraud – both criminal and civil – in Canada, the United Kingdom and the United States. The first purpose of these chapter is to demonstrate how for one type of criminal conduct we find three different approaches within the Criminal Justice System - "non-intervention", in the case of the United Kingdom, "middle intervention" in the case of Canada and, finally, "full intervention" in the case of the United States. I shall also present that, in Canada and the United Kingdom, the Criminal Justice System is virtually unused to solve insurance fraud, while the Civil System is the preferred choice when persons finally decide to judicialize the conflict. In analysing the case of the United States, my purpose is to demonstrate that even though insurance fraud has been criminalized and technically described in federal and state laws, the rate of insurance fraud keeps growing, showing the uselessness of the system in dealing with the problem.

In Chapter Five, I shall describe insurance companies' "private" responses to insurance fraud. Serving the purpose of my thesis statement, I will analyse the different responses from the insurance industry around the world in trying to prevent and detect the problem, in which I would like to denominate decriminalization *de facto*.

In Chapter Six, I shall endeavour to draw out the lessons of the previous Chapters.

I shall describe the features of criminal law responses to insurance fraud that make those responses ineffective and undesirable to insurers. I shall describe then the failure of the Criminal Justice System through analysing its limits and purposes, the behaviour out of the criminal justice system, the possibility of thinking deviance without law , a proposal for a new conflict resolution scheme, and the theories of abolitionism and radical non-intervention as a theoretical support for the subtraction of insurance fraud from the criminal justice system.

What are the criteria that ought to guide the exercise of legislative judgment regarding the appropriate occasions for invoking criminal sanction? As mentioned previously, the search for alternatives is the clue to answering the question, and it is precisely there, in the alternatives where it is possible to find solutions to problems of social control to achieve the same end, the same result – sanction, in this case using categories such as compensation, regulation, civil and administrative punishments and treatment. The real question that must be asked then is whether punishment needs to be a criminal one.

> Must we burden ourselves with the apparatus of culpability requirements and with the cumbersome processes of the criminal law to apply a sanction whose end result is a monetary exaction rather than the combination of stigma and loss of liberty that comprises the usual form of criminal punishment?[3]

My answer, based on the perception and authors such as Packer and on my own review of the law and statistics, is that we need not. Following Packer, we see a wide range of economic offences, in which insurance fraud must be included, concerning which the forms of criminal sanction "can and should be dispensed with."[4]

---

[3] H.L. Packer, *The Limits of the Criminal Sanction* (Stanford: Stanford University Press: 1968) at 252.

[4] Packer, *ibid.*, at 252.

Chapter One

In this chapter I will review six basic issues respecting insurance fraud:

(1) the meaning of the term "insurance fraud;"

(2) insurance fraud from the perspective of the offender – with reference to types of offenders and some typical offender motivations;

(3) insurance fraud from the perspective of victims/insurance companies – setting out some common types of insurance frauds;

(4) statistical information concerning fraud, showing the prevalence and cost of insurance fraud;

(5) statistics respecting fraud prosecutions; and

(6) some observations in relation to what have we learned to this point.

1. A general understanding of the concept "insurance fraud."

What is "insurance fraud"? "Insurance fraud" has many definitions, depending on the position relied on. The two positions of interest here are the legal, with its criminal and civil perspectives, and the sociological, which tries to explain negative social phenomena, among other goals. To start, I am going to provide the definition that lawyers, prosecutors, sociologists, and lay people usually employ. "Fraud" is, according to the Canadian Coalition Against Insurance Fraud, ***any act or omission with a view to illegally obtaining an***

insurance benefit.[5] The Coalition also defines "insurance fraud" as ***any act or omission that results in illicit receipt of a property and casualty insurance benefit***. This definition encompasses the full range of fraudulent acts from completely fabricated claims to "padding" otherwise legitimate claims, false statements on insurance applications, and internal fraud within insurance companies, brokerages and adjustment firms.

Fraud is, generally speaking, a behaviour that involves the honesty or good faith of one person (the victim) and the dishonesty or maliciousness of another (the person who committed the fraud). Fraud raises moral issues, like almost all other forms of deviance, in that somebody thinks that some conduct is wrong while another (very often) thinks it is not. In accordance to this description of the problem, the Supreme Court of Canada, in two relevant cases, *R*.v. *Theroux* and *R*.v. *Zlatic*, addresses the legal interpretation of fraud in relation to the concept of dishonesty. This point will be analysed in more detail in Chapter Two.

Regarding the *category of the victim*, there are two kinds of insurance fraud. The first is the fraud that is committed by a person or an organization against insurance companies, and second the fraud that is committed by the insurance companies against their clients.[6] For the purpose of this thesis, I am going to deal with the first of these categories. In fact, it is generally accepted by authors on the topic that when we say "insurance fraud," we are clearly referring to the type of fraud that is committed by a person or organization against an insurance company.[7] This type of fraud is the most common, and all the efforts worldwide to deal with it, as well as the literature that is available, relate to this type of behaviour. The second category, described properly as a type of *organizational*, is less common, and there is less information about its characteristics.

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[5] Canadian Coalition Against Insurance Fraud, "Action Plan: 1998-1999 Advancing the Cause" (Toronto: June, 1999) CCAIF special publication.

[6] E. Black, "A Premium on Fraud – When Insurance Companies Don't Pay" (1993) 79 American Bar Association Journal at 60-64.

Insurance fraud could then be defined as dishonest behaviour in a commercial transaction, in which an insurance company is the victim, and the insured is the wrongdoer.

2. Insurance Fraud from the perspective of the Offender.

I shall describe here insurance fraud from the perspective of the offender. I shall consider (2.1.) types of offenders [(i) occasional and (ii) professional]; (2.2.) Some common motivations for fraud; and (2.3) some statistical information shedding light on persons' attitudes towards insurance fraud.

2.1. Types of offenders.

Insurance fraud can be committed by almost any person who is involved in the business of insurance: the policyholder or insured who can commit fraud by exaggerating or inventing a claim or by committing misrepresentation, misdescription or omissions, intentional or non-intentional, during the subscription of the policy; the employees of the insurance company itself in complicity with professionals and suppliers such as doctors or garages; and finally intermediaries assisting insureds to present fraudulent claims.

There is no profile of a "typical defrauder." The permutations of insurance fraud and the personalities of those who commit it are as numerous and unique as there are devious minds. Despite this, two main types of defrauders have been recognized. The first are ***occasional defrauders***, those who commit fraud on isolated occasions, while the second are the ***professional defrauders,*** those professionally engaged in crimes targeting the insurance industry.

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[7] J.T. O'Malley, "Who is defrauding workers' comp?" (1998) 34 Trial (Washington D.C.) 62.

(i) Occasional defrauders.

Occasional defrauders can commit fraud for many reasons. For instance, they may be suffering a difficult economic situation and view the insurance company as an easy and safe source to get some money. Once their economic situation is resolved, they probably will not commit fraud unless a similar situation reoccurs. In relation to this first group of defrauders, it is very interesting to note that they illustrate a new kind of "morality" in our society. It is a type of morality that recognizes certain ***levels of morality*** and distinguishes between what is really harmful for society and what can be tolerated. Regarding this, Ewart says:

> Since neither the conduct nor the context of the white-collar offender's crime is clearly identifiable in nature, the use of the criminal proscription and the penal sanction is viewed by society with considerable ambivalence. This ambivalence is further enhanced by two factors: there is perceived unfairness inherent in punishing someone for conduct that might otherwise be praised and the lack of settled opinion about the conduct as clearly antisocial appears to require that a separate judgement be made each time the issue is raised. Conduct that is clearly forbidden, such as breaking into another's house or assaulting someone and taking his wallet, will result in little or no equivocation. However, where there is conduct which is not generically forbidden, but rather taboo only under certain circumstances, there arises a question, not only about the necessity for formal condemnation, but also

about the propriety of invoking a sanction.[8]

This ambivalence is certainly applicable to insurance fraud. An insurance defrauder may consider insurance fraud as a white lie, something that is not really harmful to society, conduct that nobody cares about. Our culture has tolerated this conduct, and within the group that the individual interacts with, nobody rejects him or her because of the commission of a "little lie" affecting an insurance company. Thus, insurance defrauders believe that nobody really cares about it. They think that the institution of the insurance company is something ethereal, and the offence does not harm anybody.

Continuing with the idea of the occasional defrauder, he or she may have an acceptable reputation in society and often belongs to the upper class, according to the majority of analysts of the problem. These and other characteristics set the regular offender of insurance fraud into the category of white-collar crime offender. Nightingale gives us a useful introduction to the topic:

> The usual perpetrator of the offence of fraud and other commercial criminal offences, when they occur in a commercial context, is a well-educated, "upper-class" male who is privileged in many ways and who occupies a position of respect in society. Unlike the perpetrators of other conventional crimes and the perpetrators of welfare offences, the perpetrators of fraud are not under-educated, economically disadvantaged, or members of an ethnic minority.[9]

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[8] J.D. Ewart, *Criminal Fraud*, (Toronto: Carswell,1986) at 4 – 5.

[9] B.L. Nightingale, *The Law of Fraud and Related Offences* (Scarborough, Ontario: Carswell, 1996) at 1-30. The Colombian Insurance Federation Research also reached a similar conclusion. According to this organization's research, a typical defrauder is a man, between 28 and 35 years old with university education. *See* Insurance Colombian Federation FASECOLDA-Cabrera Castillo y Asociados , "Fraud in Colombia", Bogota, 1996.

Although I agree with the first part of this statement, I cannot agree with the second in relation to insurance fraud. The range of peculiarities of the insurance fraud offender is vast. It does not just include people from the upper-class, who in fact are well represented, but also those with economic difficulties, those who have mandatory insurance and see in it the solution to their money problems. This situation is more palpable in countries such as Canada with a generalized culture of insurance, where almost everyone who owns a home has fire insurance and everyone who owns a vehicle must carry liability insurance.

(ii) Professional defrauders.

The other category of insurance defrauders is the professional, those who are dedicated to committing frauds against insurance companies, those who make their living from insurance fraud. I cannot talk about the Canadian reality because I do not have enough evidence of this behaviour in this country, even though the studies of the Canadian Coalition Against Insurance Fraud have tried to classify offenders according to certain specific social characteristics.[10] The reality in countries such as Colombia or France is more familiar to me, through my working for five years for insurance companies in the analysis of cases and the development of detection and prevention systems. In Colombia, for example, the police have discovered criminal organizations whose only purpose is to defraud insurance companies. They focus their activities on specific types of coverage, for example life or medical insurance. Their practices have reached unprecedented levels of cruelty. For instance, insuring a beggar's life for personal accidents has become very frequent. The victim is deliberately mutilated, and a few months later the indemnity is divided between the beggar and the person who paid the premiums.

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[10] The Canadian Coalition in its publication "Coalition Notes" has alerted readers to the possibility of defrauders with Latin American background. *See* : Canadian Coalition Against Insurance Fraud, *Coalition Notes*, (Toronto: Coalition Publications, July 20, 1998) at 4.

However, the common practice of professional defrauders has focused on automobile insurance fraud rather than life or health insurance. Typically, professional rings of defrauders join in efforts to steal cars, claim indemnity and sell the auto parts on the black market. The American Coalition Against Insurance Fraud has advised and warned the insurance community about sophisticated conspiracies in relation to automobile claims involving medical doctors, lawyers and their patients/clients that are widespread and one of the most costly forms of insurance fraud in the United States. A single crime ring can cost the insurance system millions of dollars per year.

2.2. Why people commit fraud: some motivations.

I do not intend to pursue a formal psychological study about the motivations for committing insurance fraud. The following observations merely help to understand the problem of insurance fraud and the potential legal or non-legal responses to it.

Some motivations for insurance fraud are as follows:

2.2.1. An Easy Crime to Commit. Insurance companies have, depending on the country, different ranges of time in which to decide the payment of the claim according to the policy wordings. They go from 10 days in Canada to 30 days in countries such as Colombia and the United States. This term is related to the time the insurance company has to perform the investigation in order to establish the causes and circumstances of the claim. In cases of fraudulent claims, this time is often too short to collect sufficient evidence to establish fraud or to obtain evidence of fraud sufficient to support a criminal prosecution. The insured knows this fact and takes advantage of it to commit fraud. Hence, the time to study the case by insurance companies encourages the commission of the "crime." In the absence of evidence, what insurance companies do is negotiate the claim with the insured or rely on civil law rules such as misrepresentation, misdescription or non-disclosure[11] to avoid the payment of the claim. In any case, the criminal responsibility is, in most cases, avoided.

2.2.2. The poor "symbolic effect" of the offence of fraud. Criminal law, according to the criminologist Stanley Cohen,[12] serves society as a means of social control. The basic premise, according to Cohen, is that individuals obey the law in part because of the legal and social consequences that follow apprehension and conviction. This is what legal scholars call the "symbolic effect" of the law.[13] On the one hand, the "symbolic effect" of the law is a type of deterrence (people obey because they fear the consequences – e.g. fines, imprisonment or social stigma). On the other hand, he "symbolic effect" of law induces obedience because we respect law itself, and because we do not want to be viewed (by others) as persons who do not respect law. When the law is respected, when it serves the purpose of preventing crimes among individuals, the "symbolic effect" is achieved. In general terms, and among societies without structural social damage or civil wars, the "symbolic effect" works for most crimes.

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[11] These are civil law doctrines contemplated in almost all the provincial Insurance Acts in Canada.

[12] S. Cohen, *Visions of Social Control* (London: Polity Press, 1985) at 112 - 197.

[13] The term *symbolic effect* of the law is used in this thesis in the sense that Ronald Dworkin give to it in his book *Law's Empire*. *See* R. Dworkin, *Law's Empire* (Boston : Harvard University Press, 1986).

For instance, people are aware of the judicial consequences of committing homicide or kidnapping (among other consequences and motivations not to commit the act), and as a consequence they behave according to the law.

The symbolic effects attaching to fraud offences, however, are relatively mild or low. Hence, the fear of legal and social consequences does not tend to override other motivations that would support committing insurance fraud.

Almost all the legislators in the western world have created an insurance fraud offence. Some countries have the general offence of fraud, others the specific crime of insurance fraud, and some others have offences such as swindling that serve the same purpose: ***to deter dishonesty among citizens***. Some people are prosecuted and convicted of swindling, some others for mail or telemarketing fraud, but just a few in the United States and Canada of insurance fraud as a criminal behaviour. Moreover, when persons are convicted of fraud offences, the penalties are not severe. For instance, in Canada probation is the most common sentence for fraud offences. The median length of a probation sentence is 450 days; the median length for a prison term is 60 days; and the median fine amount is $200.[14] The conclusion is that nobody cares about the "symbolic effect" of the law or, in other words, criminals do not care about the legal punishment for committing insurance fraud.

2.2.3. The nature of the contract.

The nature of the contract of insurance contributes to the occurrence of fraud. As

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[14] Statistics Canada, Juristat, D. E. Janhevich, "The Changing Nature of Fraud in Canada", (Ottawa: November, 1998) at 4.

Bernard Legrand says, "the very nature of the insurance contract promotes fraud."[15] An insurance contract is based on the policyholder's good faith, where honesty is of the ***utmost*** importance. Paraphrasing Legrand, first of all, an insurance contract is based on the policyholder's good faith: this may encourage abuse. At least it exposes the insurer to abuse. Secondly, it is subject to changes in the policyholders's life. Frequently, insurers are not informed of changes in risk and aggravation of risk. There is a real lack of communication on the part of insurers, Legrand says. They do not adequately explain the mechanism and working of insurance. Advertising campaigns hint at the infinite wealth of insurers without ever explaining that premiums are the source of this wealth, thus giving policyholders who commit fraud the feeling that they recover their premiums as though they were taking money from a deposit account.

When a business depends on the honesty of customers, without real instruments to determine the sincerity and good behaviour of customers, the business has an inherent risk of fraud; the internal cause is then embedded in the origin of the contract itself.

2.3. The perception of the problem.

Polling information sheds some empirical light on attitudes towards insurance fraud.

Polls[16] show that Canadians support the efforts of the property and casualty insurance industry to control the costs of fraud, and at the same time recognize insurance fraud as a

---

[15] B. Legrand, "Insurance Fraud: A European Overview" in Scor Tech "Fraud in Life and Non-LIfe Insurance in Europe," (Scor Tech, Paris,1996) 7.

[16] Canadian Coalition Against Insurance Fraud, "1996 Annual Report," (Toronto, 1997).

"common" practice among fellow Canadians.

1993: 20% believed padding a claim was acceptable. These Canadians thought fraud is "understandable" and comparable to tax avoidance.

1995: Only **5%** said padding a claim was acceptable.

1995: 70% of Canadians favoured sharing information between insurers.

1995: 47% believed that their fellow Canadians exaggerated claims.

1995 and 1996: 40% believed it was common to misrepresent information on an insurance claim.

1996: 57% said they would be willing to undergo more thorough investigation of their claims. **39%** would support anti-fraud measures even though these actions might result in a longer wait for a claim.

1996: 43% of Canadians agreed that it was easy to successfully defraud an insurance company. **47%** believed defrauders get caught. **Men (52%)** were more likely than **women (36%)** to say that insurance fraud is easy.

1996: 50% believed it is common to exaggerate claims.

Polls show that Canadians understand the link between insurance fraud and the cost of insurance; Canadians also say that insurers and policyholders together are responsible for stopping the fraud.

The study conducted by Dr. R. Litton in England,[17] perhaps the first and most complete done in that country, reveals interesting conclusions. Of those surveyed:

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[17] R. Litton, "Fraud and the Insurance Industry: Why Don't They Do Something About It, Then?" (1994) 14 International Journal of Risk at 38.

69% felt everyone commits insurance fraud.

54% admitted to knowing someone who had exaggerated a loss.

38% acknowledged that they knew someone who had invented a loss.

42% felt that companies have made fraud easy to commit.

25% felt fraud is a way of getting their money back.

20% admitted increasing a claim to cover uninsured portion of losses and to gain extra money.

4% admitted inventing fictitious claim.

Although people support the fight against crime, there is another important perception, in fact an opposite one. People believe that insurance companies are "fat cats" and feel that getting some money in this illegal way is not very serious. As Schrenk and Palmquist stated,

> A 1994 survey by the Insurance Research Council found that 9 of 10 persons surveyed were aware that insurance fraud was a factor in the rising cost of insurance, and seven of 10 said it was a major factor. The IRC also reported, however, that just under one-fourth (24 percent) of respondents felt it was acceptable to pad insurance claims to make up for premiums paid in earlier years, up from 22 percent in 1983. The industry's greater challenge is the 8 percent of people who thought it was acceptable to comply with a doctor's or lawyer's suggestion to stay out of work for longer time in order to increase an insurance settlement. There also is a hard core 5 percent of respondents who felt it was acceptable to be involved in a conspiracy with doctors, lawyers or other people to defraud insurers through false claims.[18]

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[18] L.E. Schrenk and B.J. Palmquist, "Fraud and its effects on the Insurance Industry" (1997) 64 Defence Counsel Journal at 23 – 34.

According to Guy Pochon,[19] fraud is pernicious because people are encouraged to attempt it: "why him and not me?" Gradually, the individual on the street convinces himself that he is not committing a crime but rather, just being "more clever than everyone else." People believe that insurance fraud is, in fact, an admissible practice nowadays, and moreover, a morally acceptable way to recover some of the money that the insurance companies, the "fat cats," have been collecting for years and years. In this way, to commit insurance fraud is a way to recover something that is in certain way "mine."

With respect to moral standards, insurance fraud no longer seems to be perceived as immoral among many insured. The morality of what is good and what is bad in terms of insurance fraud is changing quickly. This is where the *external causes* appear. People are looking for easy gain and take advantage of any opportunity:

> Fraud directed against public or private entities has become less serious than fraud against private property. The concept of criminality has vanished in this area. Today, it is no longer dishonest to steal from the various benefit payment systems.[20]

The European Committee of Insurers[21] says that there is no reason for this trend to be reversed. These experts anticipate neither a moral revival nor an improved job market.

Consequently, what the polls do teach us is the great grade of tolerance and acceptance of the problem in society, and how the criminal aspect of fraud, that has to be present when people think about insurance fraud, is almost completely ignored. People do not think of insurance fraud as a crime.

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[19] SCOR Tech Reinsurance, "Fraud in Life and Non-Life Insurance in Europe" (Paris: Marketing Department of the SCOR Group, 1996) at 48.

[20] *Ibid.* at 20.

[21] *Ibid.* at 48.

3. Insurance Fraud from the perspective of the Victim.[22]

The ways to defraud insurance companies are limited only by human imagination. Day by day, insurance companies, police departments, private investigators and many other parties involved in the business of insurance find more and more ways in which it is committed. The following, however, are the most common types of insurance fraud.[23]

3.1. Automobile Insurance Fraud. According to Robert W. Emerson[24] of the University of Miami, automobile insurance fraud is the most frequent type of insurance fraud. In this category, the most frequent fraud is committed in the declaration of the risk from the insured to the insurer, when the risk is changed, misrepresented, misdescribed or simply omitted. Another form of fraud in automobile insurance is the fabrication of accidents. In these cases, fraud involves theft and fire insurance, and consists of claims for fictitious theft or arson of vehicles.[25]

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[22] Forms of fraud involving Medicare and Medicaid are perhaps the most important and expensive types of fraud in the world. However, the characteristics of the crime and its nature differ from other types of insurance fraud in the sense that fraud against the systems of Medicare and Medicaid is fraud against the government instead of private institutions, and their treatment differs. In any event, Medicare and Medicaid are not categorized as insurance in the strict sense of the word. Although the systems of Medicare and Medicaid cover future risks, the elements of the contract of insurance are not present in them. For these reasons, Medicaid and Medicare fraud will not be discussed in this thesis.

[23] A 1993 report by the Ontario Insurance Commission set out the following types of insurance fraud, which are generally believed to be common across Canada. Part of this report was also included in the document *Special Investigative Units of the Canadian Coalition Against Insurance Fraud.* I am going to use basically the same classification to discuss life and non-life insurance fraud.

[24] R.W. Emerson, "Insurance Claims Fraud Problems and Remedies" (1997), 46 University of Miami Law Rev at 906.

3.1.1. Reporting phony auto thefts. An auto theft is falsely claimed in order to submit a claim. This common practice has three subdivisions.

> a. Arranging a theft, exporting the car and making and insurance claim based on the supposed theft.
> b. Arranging a car theft in order to resell its parts.
> c. Staging both the theft and recovery of an insured auto, then using its own parts in repairing damages suffered in the theft.

3.1.2. Inflating the cost of a claim to cover previous damage to an automobile. The insured in this type of case makes a claim in order to cover damages to the car that have occurred before the occurrence of the real claim, or stages an automobile accident to obtain payments under the owner's or a third party's policy.

3.2. Insuring phantom property. This type of fraud occurs frequently at the time of the subscription and consists in insuring non-existing property or property owned by someone else in order to claim its loss.

3.3. Misrepresenting how insured property is used. In the category of intentional or non-intentional misrepresentation, misdescription or omission of the facts are very common in every type of insurance fraud. These ways to defraud range from the misrepresentation of the property insured to the factual omission of the risk, for example, misrepresenting who owns or operates an automobile. In relation to homeowners' insurance, the most widespread type of fraud is a false declaration of the risk when a policy is purchased. However, the fabrication of burglary claims is one of the most painful headaches for insurance companies, as well as the exaggeration of the claims, especially when the insurer is unable to assess the risk before the issue of the policy (inspection of the risk). In this circumstance, the insurer cannot be sure about what was insured at the time of the subscription and what kind of risk was actually taken.

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[25] Canadian Coalition Against Insurance Fraud, "Red Flags for Detecting Insurance Fraud" (Toronto: Coalition Publications,1996) at 7.

3.4. Inflating the losses claimed. This is a very interesting type. Some insurers believe that is not really a type of fraud because most of the times it is done for negotiation purposes. The insured wants to obtain the maximum payment, inflating the amount of the loss in order to obtain compensation in excess of the loss. A new perspective from some sectors in the industry is to consider "exaggerated claims" not as a fraud but as another "economic risk."[26]

3.5. Committing arson. The insured deliberately sets fire to the goods insured in order to collect insurance.

3.6. Staging a burglary. An individual insures property in order to claim a false theft.

3.7. Inflating repair costs and offering kickbacks to policyholders. In the words of the Coalition, "several companies interviewed report instances where service providers (glass shops, repair garages, etc.) openly advertise they will reimburse insurance deductibles..."[27]

3.8. Multiple Coverages. Individual accident insurance is also significantly affected. This kind of fraud is well defined by SCOR TECH as " the taking out of policies for high lump sums for injury with several insurance companies."[28]

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[26] J. Wagstaff, "Insurers British Association, 1998 Annual Report" (London: 1998) at 21.

[27] *Supra* note 26 at 12.

3.9. Life Insurance Fraud. Finally, life insurance fraud is one of the most "morally reproachable" insurance frauds. With simulating accidents, murders, and deaths that never took place,[29] or misrepresenting the risk as well as the insurable interest in the underwriting process, life insurance fraud is categorized as the second most common insurance fraud after automobile insurance fraud.[30]

4. The Extent of the Problem.

To get an idea of how important the problem of insurance fraud can be, an overview of some statistics about the prevalence and cost of fraud. We will consider, Canadian statistics (4.1.), United States statistics (4.2.), and European statistics (4.3.).

4.1. The Extent of Insurance Fraud in Canada.

It is important to note that during 1997 and 1998, fraud offences were the highest among violations against property. Experts believe that more than 40 percent directly relate to insurance fraud.[31]

Other Frauds in Canada

1995	**44,727**

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[28] *Supra* note 20 at 3.

[29] P. Jesilow, H.N. Ponteli and G. Geis, *Prescription for Profit - How Doctors Defraud Medicaid* (Los Angeles: University of California Press, 1993) 12.

[30] *Supra* note 25 at 967.

[31] Statistics Canada, Canadian Crime Statistics, catalogues numbers 85-002-XPE and 85-205-XPE

1999	42,053
Variation	-0,06[32]

Property and casualty insurers in Canada believe that at least 10% to 15% of household, automobile and commercial insurance claims are fraudulent, either completely fabricated or inflated, totalling about $1.3 billion a year in fraudulent claims that must be paid from the premiums of all policyholders, more than 20% of the claims.[33] These numbers are based on fraud that the insurance companies could measure. Of course we only know of the known crimes, frequently called apparent crimes.[34] The real extent is impossible to know.

The Canadian insurance industry has stated the cost of insurance fraud in the following terms:

> While it is impossible to pinpoint precisely the magnitude of the insurance fraud problem because of different measuring techniques, it is clear that the insurance industry in Canada has suffered fraudulent claim losses in dollar amounts ranging from $1.3 to as much as $2.6 billion annually. When the full extent of application fraud is added to these amounts, it is safe to assume that anywhere between 8% on the low end up to as much as 30% of premiums received are going toward the cost of covering application and claim fraud.[35]

Beyond the impact on the insurance industry in terms of premiums paid by consumers, insurance fraud has secondary financial consequences. Police must investigate crimes in which details have been altered (or which never occurred), making the investigation more costly and time consuming. Fire fighters risk their lives and spend valuable resources extinguishing arson fires. Fire marshals investigate the cause of the fires. Health services treat patients injured in arson fires or staged accidents or who fake injury to make claims.

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[32] *Supra*, at 12

[33] *Supra*, note 15, at 15.

[34] We are following the terminology of criminal law in relation to "apparent crimes" and "hidden crimes".

[35] Canadian Coalition Against Insurance Fraud, *Special Investigative Units – A Manual* (Toronto: 1995) at .3.

When the toll on police and fire resources is factored in, insurance fraud costs an additional $1 billion per year.[36]

Public awareness campaigns are helping to increase the understanding of the consequences of insurance fraud. The media emphasize the fact that ***10 to 15 cents of every premium dollar go to pay fraudulent claims,*** and underline the significant "hidden" costs that insurance fraud has on social resources such as fire and police departments and the health care system. Recent polls show that public tolerance of insurance fraud has dropped off to just 4% from 20% five years ago.[37]

4.2. The Extent of Insurance Fraud in the United States.

The Federal Bureau of Investigation has estimated the cost of insurance fraud to be $67 billion per year.

Insurance fraud cost each American family an estimated $1,030 in 1995. These are direct costs that have raised the price of health, auto and homeowners' insurance premiums and increased the price customers pay for goods and services an estimated total of $85.3 billion per year. In addition, insurance fraud results in the cancellation of premiums that consumers have paid and leaves them with unpaid claims, sometimes leading to financial ruin.[38]

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[36] Canadian Coalition Against Insurance Fraud, *Coalition Notes* (Toronto: April, 1998) :2.

[37] *Supra* note 17.

The Florida Insurance Research Centre at the University of Florida has established that the estimated annual cost of auto insurance and third passenger fraud exceeds $364 million American dollars per year.[39] Meanwhile, the cost of health care insurance fraud in the United States of America is $100 billion per year.[40]

4.3. The Extent of Insurance Fraud in Europe.

In Europe, the cost of fraud in 22 countries that participated in an international survey was estimated to be eight billion euros per year. The French Reinsurance Company SCOR states that this amount is only a vague estimate because fraud is a hidden problem and difficult to assess. In any event, this amount of eight billion euros can be considered a conservative estimate.[41] To simplify, it can be said that the cost of fraud in the 22 countries that SCOR studied is greater than or equal to the total annual premium income of all insurance companies combined in countries such as Finland, Denmark and Austria.[42]

In Finland, Denmark and Austria, it has been determined that costs derived from insurance fraud represent 15 to 30 per cent of payments made by insurance companies for claims. In Spain, UNESPA (The Spanish Federation of Insurers) has said that the cost of fraud reaches 3.5 million dollars for each company in the Spanish industry per year.[43] This situation is common among all countries that have a typical insurance industry. The economic costs of fraud, analysed in the middle 1970's,[44] played an important role in the creation of specialized institutions for fraud analysis and the design of strategies that permit the control and punishment of the problem.

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[38] Coalition Against Insurance Fraud, *Annual Report 1997* (Washington D.C. 1998).

[39] Florida Insurance Research Centre, *Auto Insurance Fraud Study*, (University of Florida, May 30, 1990).

[40] J.R. Biden, "Combating health care fraud" (1995) 32 American Law Review,at 234-256.

[41] *Supra* note 20 at 17.

[42] B. Legrand, *Fraud in Europe* (Comitté Europeén des Assurances (CEA), Paris, 1997).

The situation in England is not too much different from the Canadian one. The Association of British Insurers considers fraud to be a real catastrophe for the industry, estimating the cost of fraud in 1999 at more than 650 million pounds, the equivalent of approximately one billion dollars.[45]

5. Statistics concerning Fraud Prosecutions.

> There is history – there is such a thing as statistics – which provide with the most complete evidence that since Cain the world has been neither intimidated nor ameliorated by punishment. Quite the contrary.
>
> Karl Marx[46]

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[43] P. Wibbois, *Insurance Fraud in Spain*, SCOR TECH, Paris, 1996, p.30. Wibbois is director and chief executive of group Azur assurances Spain, and vice president of the technical commission of UNESPA.

[44] Before that time, accordingly to T.J.O'Malley, "...insurance companies had been inclined to take the route of simply passing along the costs of fraud to the consumer. The demand for insurance has been relatively inelastic to price changes, so it was essay to shift the costs to consumers without seriously reducing demand. But with greater regulatory scrutiny on pricing and increasing competition, insurers will not be able to continue to transfer these costs to consumers. They will be forced to reduce the cost of fraud below a level that is economically feasible to absorb. It is more than a societal moral commitment. Insurers have an obligation to their stakeholders to maximise the value of the company and therefore to invest wisely in measures designed to detect and deter fraud..." *supra* note 7 at 34

[45] Association of British Insurers, *Crime & Fraud Prevention Bureau - Annual Report 1999* (London: 200).

[46] K. Marx, "Capital Punishment", in L. Feuer, ed., *Marx and Engels: Basic Writings on Politics and Philosophy* (Garden City, New York: Anchor Books, 1957) at 487-489.

Compiling insurance fraud, prosecution and conviction statistics is not an easy task. The problem is barely measured by the authorities, and it is often included among other forms of fraud such as telemarketing, credit card or computer fraud when it is not associated with other property crimes such as forgery. In any case, statistical reports from government authorities that include insurance fraud as a sole category are rarely found.

On the other hand, the information compiled in relation to insurance fraud, and for fraud in general, represents only a small fraction of the real problem. Fraud is perhaps one of the least reported crimes, which implies that the numbers found in the official reports barely represent the real scope of the problem.

My purpose in the following section is to compare the official statistics on fraud to the criminal justice statistics in order to demonstrate how the criminal justice system is clearly not responding to the situation of the problem in terms of registration of the cases, prosecutions and convictions.

We shall consider fraud prosecutions in (5.1.) Canada, (5.2.) England and (5.3.) The United States.

5.1. Canada.

Even though there are no complete surveys concerning insurance fraud specifically, there are two major sources that provide a very good illustration of the actual problem. These are the Canadian government, through its Canadian Centre of Justice Statistics, and the private company KPMG, which has been researching the problem since the mid-1980's.

According to the information provided by the Canadian Centre of Justice Statistics in its publication Jusristat, the following is the actual scope of the problem and its recognition by the criminal justice system. It is important to say that the fraud category includes not only insurance fraud, but every other type of fraud.

	1998	**1999**
Incidents Reported	94,575	90,568
	1998-99	
Cases heard in adult court	20,835	
	1998-99	
Conviction rate	60%	
	1998-99	
Decreasing rate	-3%[47]	

From the 21,594 frauds committed between 1995 and 1996, a total of 2,795 (13%) were committed according to the definition in section 362 of the Criminal Code, "obtaining by false pretence, fraud, or false statement," the section that could fit the description of insurance fraud. However, the proportion in the category "other frauds," in which the government includes insurance fraud, represents **43%** of the total number of frauds committed in Canada in 1996. The only information that the government of Canada has in relation to insurance fraud directly is that provided by the Insurance Bureau of Canada and its Coalition Against Insurance Fraud, information presented in numeral 4 of this Chapter.

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[47] This is not a decrease in cases of insurance fraud. According to the publication *Juristat* the decrease is due to the decrease in cheque fraud because of the less frequent use of cheques: *See* Statistics Canada - Juristat, (Ottawa :November, 1998) section 4.1.

5.2. England.[48]

England, as does Canada, includes every single type of fraud and the crime of forgery within the "fraud in general" classification, creating the same problem as in the Canadian statistics where it is impossible to determine how much of the amount presented really corresponds to insurance fraud.

	1998-99
Total offences (fraud and forgery)	255,454
	1998
Increasing rate	28%
	1998
Persons convicted	3.7%
	1998-99
Cleared offences	36%

As in the Canadian case, once again the reality presented by the industry is not reflected by the official statistics.

5.3. The United States of America

The statistical reports reveal the following situation.[49] Again, the data do not refer only to insurance fraud but to every single type of fraud that the American legislation contemplates.

	1998
Number of offences	978.148
	Oct. 97 - Oct. 98

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[48] The statistical information was taken from *Criminal Statistics England and Wales - 1998*, (Home Office, London, March, 2000).

[49] Bureau of Justice Statistics, *Compendium of Federal Justice Statistics* (Washington D.C., 1999).

Arrests for fraud	10.084 (9.7%)
	Oct. 97 - Oct. 98
Suspects in fraud received by U.S. attorneys	19.418 (17.0%)
	Oct.97 - Sept. 98
Sentence types in cases terminated	Total sentenced: 7,532 60.9% incarceration 34.6% probation 1.4% mixed sentences 1.2% fine

6. Some observations.

From the foregoing sources, and as an overview, we can highlight the following relevant facts that may cause us to rethink the legal treatment of insurance fraud:

1. The only reason that the general offence of fraud is decreasing in Canada is that there is a significant decrease in the reporting of fraud cases. The decrease in a rate does not establish a reduction in the commission of the offence.

2. According to trends from 1977 - 1996, the category ***other fraud***, in which insurance fraud is located, has increased by **72.2 %**.

3. Insurance fraud, according to the Canadian Coalition Against Insurance Fraud, costs approximately $1.3 billion annually, and an additional $1 billion per year in police and fire department costs. Health costs to victims and firefighters are other unmeasured costs.

4. In North America, insurance fraud is estimated to be second only to illegal drug sales as a source of criminal profits.

5. In a 1996 public opinion poll regarding insurance fraud, **60%** of the respondents believed that it was common and acceptable to exaggerate claims.

6. In a 1997 Canadian Survey concerning fraud, among 1,000 companies, with

insurance companies representing about **20%** of the sample, the results were the following:

- Half of the companies believed that fraud has to be reported to the authorities.

- **52%** of the fraud discovered was through the use of internal controls.

- **48%** believed that fraud is a problem, and 38% believed it is not.

- **55%** believed that the level of fraud would increase in the next five years.

- **47%** believed that the cause of fraud is the poor internal control in the companies

7. In a 1995 Police Chiefs survey done by KPMG, some of the most important results were as follows:

- **69%** of Police Chiefs believed that their departments are under-resourced to deal with insurance fraud.

- **68%** believe that it is better to combat drug problems and violent crimes instead of fraud.

- **73%** believe that white collar crimes are not a priority for the police.

- **71%** believe that fraud is a problem that concerns private companies.[50]

It is very difficult and probably irresponsible to offer conclusions based on the poor statistical information we have. But certainly there are two aspects of the problem that do not fit at all. The first one comes from the industry, where apparently the problem is seriously jeopardizing the normal development of business in Canada, and where in the non-life insurance business alone the cost of the problem is more than $2.3 billion per year.

In this chapter I have stated the meaning of the term "insurance fraud" and its various approaches from the perspective of the offender and the victim, and how insurance fraud is indeed a serious economic problem around the world. In the next chapter I will begin the discussion of the legal tools used to combat insurance fraud.

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[50] Coalition Against Insurance Fraud, *Annual Report 1998* (Washington D.C., 1999).

Chapter Two

Legal Aspects of Insurance Fraud in Canada.

In this chapter I shall analyse the legal tools developed in Canada to combat insurance fraud, both in the criminal law and the civil law, and the modest but incomplete evolution of the legal treatment of fraud. I will deal with the Canadian Criminal Code, specifically the pre-1948 regime, the 1948 amendments, and the post-1954 amendments, and with the Supreme Court of Canada's interpretation of criminal fraud. I will also deal with the Civil Law in Canada, the evolution of the laws related to fraud, misrepresentation, misdescription and non-disclosure in the Insurance Act of Alberta, 1915-1999. I will close with a review of the Canadian judicial approaches to insurance fraud.

> Embezzlement or peculation of money or goods entrusted in trade, fraud in purchase or sale, if done before the eyes of the party who suffers, are private crimes. On the other hand, coining false money...theft, robbery, etc., are public crimes, because the commonwealth, and not merely some particular individual, is endangered thereby.
>
> Immanuel Kant[51]

1. The Canadian Criminal Code.

In this section I shall consider (1.1) the pre-1948 fraud regime, (1.2) the 1948 amendments and (1.3) the post-1954 amendments.

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[51] I. Kant, *The Philosophy of Law*, Part II, (Edinburgh: T.T. Clark, 1887), at 194.

1.1. Pre-1948 Regime.

To the surprise of many authors on this topic such as Nightingale[52] and Ewart,[53] prior to the reform of 1948, the Canadian Criminal Code did not include the substantive offence of fraud, although it did penalize conspiracy to defraud. A substantive offence is defined by Black's Law Dictionary as " a crime that is complete in itself and is not dependent on another crime for one of its elements."[54] Therefore, the difference between the *substantive* offence of fraud and the *non-substantive* offence of fraud is that the latter depends on the element of *conspiracy* to be considered as an offence. Two matters attract our attention. First, with respect to the offence itself, the Canadian Criminal Code before 1948 defined the offence of "conspiracy to defraud" as follows:

> 394. Everyone is guilty of an indictable offence and liable to seven years' imprisonment who conspires with any other person, by deceit or falsehood or other fraudulent means, to defraud the public or any person, ascertained or unascertained, or to affect the public market price of stocks, shares, merchandise, or anything else publicly sold, whether such deceit or falsehood or other fraudulent means would or would not amount to a false pretence as hereinbefore defined.[55]

In England, where the offence of fraud still exists only for cases where the element of conspiracy is present, conspiracy tofraud is defined, according to Michael, as "an agreement to practise a fraud on somebody."[56] It is interesting to notice that the element of conspiracy in England as well as in Canada refers to the planning of the crime and not necessarily to the action of committing it. In words of Mewett and Manning:

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[52] Nightingale, supra, note 10 at 24.

[53] Ewart, *supra*, note 8 at 37.

[54] *Black's Law Dictionary*, 7th edition, (St. Paul, Minn., 1999) at 1110.

[55] S.C. 1892, c.29, s.394.

> The offence of conspiracy consists in the agreement (the actus reus) and the objective of the agreement (the mens rea). As far as the actus reus is concerned, it is the agreement itself that is criminal. It is immaterial whether steps are or are not taken to carry out the objects agreed upon . . . There must also be a common design to do something unlawful... Although it is not necessary that there should be an overt act in furtherance of the conspiracy, to complete the crime . . .[57]

Since 1892, the offence of conspiracy to defraud has applied to commercial affairs. Even though the term "commercial affair" is not mentioned in the law itself, fraud offence refers us to typical cases of "commercial affairs." The question then is, is insurance a commercial affair? Certainly it is. The basic premise of insurance is that it is a service in which somebody is selling a product, the coverage of one person or material goods with respect to a certain risk.[58]

The second matter attracting our attention is the exclusion of criminal liability in the absence of conspiracy. Before 1948, in the words of Ewart, " one person's ability to trick another was of no public concern, and would not constitute a substantive criminal offence."[59] In other words, if one person, before 1948, committed a fraud by himself against another sole individual the offence of fraud could not be applied, but if the person committed the offense with another person then the crime could be prosecuted. The thinking about fraud at that time in legislative history was clearly stated by Holt C.J. in *R.*v. *Jones*[60]: " Shall we indict one man for making a fool of another?"[61]

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[56] A.J. Michael, *Criminal Law* , 3rd edition (London: Blackstone Press, 1999) at 251.

[57] A.W. Mewett and M. Manning, *Criminal Law* (Toronto: Butterworths, 1996) at 153.

[58] E.R. Hardy Ivamy, *General Principles of Insurance Law*, 6th edition, (London : Butterworths, 1993) at 3-18.

[59] Ewart, *supra* note 8, at 10.

Certainly this is, in my opinion, a surprising view of fraud. The principle behind this statement of Holt C.J. and the legislation prior to 1948 in Canada could be clarified as follows. If one person, who was the intellectual equal of another – without any measure that could give risk to the public or threatening public morals or the security of the society in general – defrauded somebody, the behaviour was not categorized as criminal fraud. In other words, fraud between two equal persons (two sole individuals) was not categorized as a fraud except in cases when two or more people agreed to commit fraud against a sole individual. The model that the legislator had in mind was the "free market" where commercial frauds and other undesirable commercial practices had to be prevented. The principle behind this position is well explained by Ewart as follows:

> More important however, was the view that individuals could not be expected to be able to defend themselves from the trickery of two or more persons acting in concert. Both the law concerning false measures and the law of conspiracy to defraud emphasized the general rules that individuals were expected to take whatever measures were necessary to prevent their being cheated by another individual acting on his or her own.[62]

Conspiracy, rather than fraud, seems to have been the evil. Before 1948, what the legislator apparently wanted was to protect society precisely from groups of people who can actually plan strategies to defraud against innocent unproteced people.

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[60] *R.* v. *Jones*, (1703), 2 Ld. Rayman. 1013, 92 E.R. 174.

[61] Ewart, *supra*, note 8, at 7

[62] Ewart, *supra*, note 8, at 12.

The specific protection of the stock exchange from polls of brokers and companies shows why the offence of fraud established before 1948 included the element of conspiracy to defraud.[63] The offense of fraud committed by polls of brokers and companies fits perfectly in the category of "conspiracy to defraud" because it is usually planned and committed by more than one perpetrator. So, the conduct before 1948 was not criminal if the fraud was "fair" – one perpetrator, one victim – and was criminal if the fraud was "not fair", when it was committed by two or more perpetrators against one victim.

The consequences in terms of insurance fraud are clear. To prosecute and to punish insurance fraud was perfectly possible if members of a group of people, or a criminal organization, have or had the intent to commit an act of fraud against an insurance company. However, in 1948 and before, and even today, insurance fraud as an offence committed by an organization is less common than fraud committed by individuals.[64] Therefore, the individual insurance fraud case, or other fraud against individuals not necessarily related to insurance, was simply not prosecuted and punished by Canadian Criminal law.

What then was the solution to this problem before 1948 for those cases in which conspiracy was not present? Apparently, the civil law, through the Insurance Acts, tried to give some solutions and treatment to the problem. In the same manner, the common law in the private and the public domain gave some solutions to the problem as well, as I will explain below.

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[63] *Supra*, note 8 at 14.

[64] The first source for this statement is the book written by A.C. Campbell, *Insurance and Crime* (New York: G.P. Putnam's Sons, 1902) at 310, probably the first book written in the specific topic of insurance fraud. The author states clearly the fact that insurance fraud is most a *personal* crime rather than a *organized* form of crime. The second and "modern" source to support this statement is the article by R.W. Emerson "Insurance Claims Fraud Problems and Remedies", *supra* note 25, where the author states that even though the organized insurance fraud is growing, its commission by individual perpetrators is still the most common form.

1.2. 1948 Amendments.

Continuing with the historical development of the offence of fraud, and in particular with its legislative development, the Criminal Code reform of 1948 made a radical change in its approach to the problem. The amendment of section 444[65] was not obviously significant on the surface, as what Parliament did was simply to delete the word "conspires." But in doing so it took a huge conceptual step in the fight against fraud by creating a *substantive offence* of fraud. (This, however, was not a necessarily huge practical step in the fight against insurance fraud, as I will explain further.) The text of the amended section 444 reads as follows:

> 444. Everyone is guilty of an indictable offence and liable to five years' imprisonment who, by deceit or falsehood or other fraudulent means, defrauds the public or any person, ascertained or unascertained, or affects the public market price of stocks, shares, merchandise, or anything else publicly sold, whether such deceit or falsehood or other fraudulent means would or would not amount to a false pretence as hereinbefore defined.[66]

Since this amendment, as a result of the deletion of the word "conspires," Canadian prosecutors have had a new instrument to fight against almost any form of fraud, including insurance fraud. As A.B. Harvey notes,

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[65] S.C. 1948, c.39, s.444.

[66] S.C. 1948, c.39, s.444.

> Of much greater importance, however, is the fact that this new form of the section, whether intentionally or not, creates an entirely new offence . . . It is difficult to think of any circumstance in which the well-established offence of obtaining money, goods or credit by false pretenses would not be included in the wording of the new section 444...

Since the amendment of 1948 seems to be the most important one in the history of the fraud offence, it is quite interesting to check references in the Debates in The House of Commons back to June 14, 1948 in relation to the issue.

In the words of the honourable representatives:

> Mr. ILSLEY : Section 13 requires some explanation. *It was an essential ingredient of the offences that there is conspiracy. Now there does not need to be conspiracy*. The conspiracy sections in the code, elsewhere provided, will, of course, takes effect if there is conspiracy. Now there does not need to be conspiracy. Everyone is guilty of an indictable offence and liable to five years' imprisonment who, by deceit or falsehood or other fraudulent means, defrauds the public or any person, ascertained or unascertained, or affects the public market price of stocks, shares, merchandise, or anything else publicly sold, whether such deceit or falsehood or other fraudulent means would or would not amount to a false pretense as hereinbefore defined.(emphasis added)
>
> MR. ILSLEY : ... The main part of the sections is to do away with the necessity of proving conspiracy. That is the purpose of the section. The wording has been in the code before, but heretofore the words were "conspires with any other person" to do it. No conspiracy is now necessary in order to obtain a conviction under the section.
>
> Mr. DIEFENBAKER : I have always found that when the crown did not have a strong case and wished to introduce a lot of hearsay evidence of discussions that took place among individuals, whether joined together at the moment or not, it invariably charged conspiracy. When conspiracy is charged, statements made by one alleged conspirator in the absence of another are admissible, and the result is that often it is difficult to defend, however good to defence might be, when the charge is conspiracy. I am wondering why the necessity of stablishing conspiracy, which, after all, is not a very difficult matter in any case, is being deleted, and an overt act of deceit or falsehood is substituted

> without the necessity of establishing conspiracy.
>
> MR. ILSLEY. The conspiracy section can still be used. The fact that you take conspiracy out of this section does not mean that is not an offence to conspire. That is constituted by the conspiracy sections.[67]

Clearly, the purpose of the amendment, according to Minister Ilsley, was "to obtain conviction under the section." The former provision had not been sufficient to prosecute people who commit fraud without conspiracy. In brief, thus far, we have seen that prior to 1948, the offense that existed was just the conspiracy to defraud, whereas the new piece of legislation allowed prosecutors to convict defrauders as individuals and not necessarily as a part of a conspiracy.

Why did the law of fraud change in 1948, and what were the real origins of the change from a non-substantive offence to a substantive one? What stopped pre-1948 legislators from "seeing" fraud as a general offence? The explanation could go from social relevance, necessity of the law, to simply coincidence. The references in the House of Commons give us some clues respecting the necessities that the representatives considered in producing the change; these however, are too vague and lack historical context.

It is well known that many aspects of legislation around the world were affected by post-war developments in political philosophy, human rights and international trade, among others. The amendment in the Criminal Code of 1948 respecting the law of fraud apparently had no connection with these new trends.

The new version of the law of fraud, however, has a clear and precise link with a political and economic situation in the Canada of the 1930's, and the development of Canadian Securities Regulation. For instance, the Manitoba Sale Shares Act of 1912 introduced "anti-fraud measures directly into the field of securities law as such,"[68] and the Dominion Companies Act of 1934, following The English Companies Act of 1928, introduced severe measures in relation to the behaviour of shareholders and the prohibition on "door-to-door sales securities," and the fraud that this behaviour often involves.

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[67] *House of Commons Debates* (14 June 1948), at 5189.

A policy approach of *blue skies*[69] in the internal commerce and financial affairs as well as in the security markets, an approach that meant a "new emphasis upon self-regulation to controlling securities markets,"[70] started to create some problems. A chain of commercial and financial scandals that involved fraud in every possible form and the drop in the Canadian markets as a consequence of the dishonesty of the brokers established new perspectives in the legal treatment of fraud. As Christopher Armstrong explains,

> Following serious scandal on the Standard stock exchange in 1927 the government of Ottawa began to consider new means of fighting fraud. The challenge was to draft enforceable legislation which would control both primary and secondary trading of securities but be immune to the constitutional challenges that had disabled blue-sky legislation. Day-to-day supervision of trading by the exchanges would be combined with closer enforcement to prevent dishonest activities"[71]

The appearance of *Security Fraud Prevention Acts* in provinces such as British

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[68] D.L. Johnston, *Canadian Securities Regulation*, (Toronto: Butterworths, 1977) at 14.

[69] The term "blue skies" refers to a body of laws enacted in the 1920's in relation to the development of the exchanges and their faltering efforts at self-regulation by increasing demand for government regulation of securities markets.

[70] C. Amstrong, *Blue Skies and Boiler Rooms, Buying and Selling Securities in Canada*, 1870-1940 (Toronto: University of Toronto Press, 1997) at 141.

[71] *Ibid.* at 116.

Columbia and Ontario helped in some manner to control fraud. However, the people who committed fraud as a sole individuals continued to avoid criminal liability. The scandal of Had Hirshborn and Joseph Hirshorn who, as shareholders of a mine company, committed fraud in inflating the stock artificially by wash trading without the element of "concealment to defraud" was the cause for a rethinking of the criminal legislation respecting fraud. In the context of this scandal, John Godfrey, a commissioner in the Ontario Securities Commission, confronting the absence of criminal liability for the Hirshornes, noted that "under the present law [referring to the section 444 of the criminal code in 1932] the lone wolf may commit any depredation. It is only when he hunts with the pack that he becomes a criminal."[72] Clearly, Godfrey noted the lack of a substantive offence of fraud and its consequences in the prosecution, in this precise case, of "white collar" criminals. While the circumstances calling for legislative amendment occurred in the 1930's, it was not until the 1948 that section 444 of the Criminal Code was finally amended.

Otherwise, the reform of 1948 was apparently sufficient enough to deal with any possible form of fraud in relation with commercial affairs, and, even today, the law still, in general terms, remains appropriate for the same purpose.

1.3. Post-1954 Amendments.

Continuing with the historical evolution of the law, section 444 of the 1948 statute was amended in 1954[73], but few changes were incorporated. In particular, the section was rewritten to shape it in the style of the new Code and to give more emphasis to the point that the type of fraud that the section refers to concerns commercial transactions only, to differentiate it, for example, from election fraud or other non-commercial types of the conduct. Furthermore, a new subsection was created to deal with *stock market* fraud.

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[72] *Ibid.* at 252.

Since 1954, the definition of the offence has been more or less the same. Except for two minor changes in the text concerning the definition of the offence and its penalties, the first dealing with the new style of the Code and the second with the importance that the legislator wanted to give to the crime, the law involving the offence of fraud has been almost the same since 1948.

Since the last amendment of 1997, the offence of fraud, now section 380, reads as follows:

> 380. (1) Everyone who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretense within the meaning of this Act, defrauds the public or any person, whether or not it is a false pretense within the meaning of this Act, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service,
>
> (a) is guilty of an indictable offence and liable to a term of imprisonment not exceeding ten years, where the subject matter of the offence is a testamentary instrument or the value of the subject-matter of the offence exceeds five thousand dollars; or
> (b) is guilty
> (i) of an indictable offence and liable to imprisonment for a term not exceeding two years, or
> (ii) of an offence punishable on summary conviction,
> where the value of the subject-matter of the offence does not exceed five thousand dollars.

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[73] S.C. 1953-54,c.51,s.323.

> (2) Everyone who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretense within the meaning of this Act, with intent to defraud, affects the public market price of stocks, shares, merchandise or anything that is offered for sale to the public is guilty of an indictable offence and liable to imprisonment for a term not exceeding ten years.

It is interesting to note that the second point in the new version of the definition of the offence was created in order to give specific protection to the *market price of stocks, shares* and *merchandise*. Thus, it is possible to deduce that Parliament wanted to be very specific in relation to certain social effects of the legislation.

If the legislator preferred to give specific protection to the fraud affecting the market price of stocks, shares and merchandise, why did it not contemplate computer fraud, telemarketing fraud or insurance fraud as well? We do not know. The process of criminalization follows the volition of the legislator, which is not always clear and in correspondence with the reality of social phenomena.

2. The Supreme Court of Canada and the concept of fraud.

Because the precise offence of insurance fraud is not contemplated in the Canadian Criminal Code, the main offence relevant to insurance fraud cases is the offence in section 380 dealing with fraud in general.

It is important therefore to analyze how the Supreme Court of Canada, through cases such as *R.* v.*Theroux*[74] and *R.* v. *Zlatic*[75], has interpreted and applied this offence. These judgements specifically focus on the issue of the intent to defraud and the change in the traditional approach to the concept of ***mens rea***.

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[74] *R.*v. *Theroux*, [1993] 2 S.C.R. 5, 19 C.R. (4th) 194,79 C.C.C. (3d) 449.

[75] *R.*v. *Zlatic*, [1993] 2 S.C.R. 29, 19 C.R. (4th) 230, 79 C.C.C. (3d) 466.

The ***actus reus*** of fraud is established by proof (beyond reasonable doubt) of,

(a) deceit,

(b) falsehood, or

(c) "other fraudulent means;" and

(d) deprivation caused by (a), (b), or (c), which consist in

(i) actual loss, or

(ii) placing a victim's pecuniary interests at risk.

The ***mens rea*** of fraud is established by proof (beyond a reasonable doubt) of

(a) subjective knowledge of the prohibited act (deceit, falsehood, or "other fraudulent means"), and,

(b) subjective knowledge that the prohibited act

(i) will cause or caused actual loss, or

(ii) placed a victim's pecuniary interests at risk.

Mens rea is established whether the accused intended to cause loss or was reckless about whether loss would occur.

The "other fraudulent means" of the ***actus reus*** has been clarified by the Supreme Court. These are actions, other than deceit or falsehood, which a reasonable person would judge to be dishonest. In this sense, whether an act amounts to "other fraudulent means" is determined "objectively." This application of the reasonable person standard and the characterization of this aspect of the ***actus reus*** as "objective" does not entail that the offence may be established on proof mere negligence.

As McLachlin J. stated,

> I am satisfied that a reasonable person would regard as dishonest a scheme involving the acceptance of merchandise for resale without concern for repayment and the diversion of proceeds to a reckledd gambling adventure. The distinction is the same as a distinction between a corporate officer using corporate funds for unwise business purposes, which is not fraud, and the diversion of corporate funds to private purposes having nothing to do with business. Unwise business practices are not fraudulent. The wrongful use of money in which others have pecuniary interest for purposes that have nothing to do with business, may however, in appropriate circumstances, constitute fraud.[76]

Examples of "other fraudulent means" recognized in cases include the use of corporate funds for personal purposes, non-disclosure of important facts, exploiting the weakness of another, unauthorized diversion of funds, and unauthorized arrogation of funds or property.

In *Theroux* and *Zlatic*, the Supreme Court also clarified an aspect of the ***mens rea*** of fraud. If the mens rea is established, as outlined above, it is irrelevant that the accused

(a) thought that what he or she was doing was not morally or legally wrong, or

(b) believed that the prejudice or risk of which he or she was subjectively aware would be subsequently reduced or compensated for by a future event.

The Supreme Court's approach to fraud clearly permits the prosecution of insurance fraud cases. Most cases of insurance fraud will be cases of deceit or falsehood, fully supported by the intention to extract funds from the insurer. Exotic forms of fraud could be captured under the "other fraudulent means" branch of fraud.

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[76] *Ibid.* at 242 (C.R.)

In the decision of *R*.v. *Gaultier*[77] a member of a Crop Insurance Board was charged with defrauding the Manitoba Crop Insurance Corporation by submitting a false claim. However, the false claim was made with the intent of "testing the system" to determine its resistance to cases of fraud. The Manitoba Court of Appeal found that the accused had knowledge that the claim was false and could foresee that the insurance company would pay the claim. In this case the Court determined that the fact that the accused did not want to deprive the Company with a false claim did not negate the intent to defraud.

3. The Civil Law in Canada.

Civil law takes a legal approach to the problem of fraud that contrasts with the criminal approach. The civil definition of fraud is framed in statutes in Alberta[78] and Ontario[79] to permit the insurer to avoid the payment of a claim, and to permit the automatic cancellation of the insurance contract in cases when fraud is detected. Misrepresentation, non-disclosure and misdescription are civil concepts that help the insurer to respond to forms of fraud without the necessity of using the criminal justice system.

On the whole, criminal law, with the law of "conspiracy to defraud" coined in 1892 in the Canadian Criminal Code, and the amendment in 1948, has been a criminal instrument to fight against insurance fraud. At the same time, civil law, since 1915 in the first Alberta Insurance Act, also provides legal instruments to confront the problem. Which one is better, if one of them is, in terms of controlling effectively the occurrence of fraud? In order to answer this question, it is important to analyze the legislative process of both laws, their historical development and the empirical application through the judges' decisions.

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[77] *R.* v.*Gaultier*, [1993] M.J. No. 247, online: QL (FCJ).

[78] *Insurance Act of Alberta*, 1999, s.546 and ss.

[79] *Revised Statues of Ontario*, 1990, s.148 and ss.

3.1. Evolution of the laws related to fraud, misrepresentation, misdescription and non-disclosure in the Insurance Act of Alberta. 1915 - 1999.

Civil remedies for fraud were first contemplated in the Alberta Insurance Act in 1915 when the first Act respecting insurance appeared. In this first civil text, under the heading of Statutory Conditions, we find the definitions of misrepresentation and the definition of fraud. Misrepresentation and fraud permit the cancellation of the contract and denial of the payment by the insurance company. The section in the statue from 1915 reads as follows:

> Statutory Conditions
> 1. If any person insures property and causes the same to be described otherwise than it really is to the prejudice of the company, or misrepresents or omits to communicate any circumstance which is material to be made known to the company, in order to enable it to judge of the risk it undertakes, such insurance shall be of no force in respect to the property in regard to which the misrepresentation or omission is made.
>
> 2. Any fraud or false statement in any statutory declaration in relation to any of the above particulars shall vitiate the claim of the person making the declaration.[80]

The same statutory conditions were preserved in the Alberta Revised Statues of 1922.

By 1942, the Revised Statues of Alberta included more specific and technical provisions for life, fire, automobile and hail insurance relating to fraud, misrepresentation, non-disclosure and misdescription. The new text of the law in 1942 was approximately the same as that we have today and constitutes the modern civil approach to insurance fraud.

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[80] *Act Respecting Insurance*, R.S.A. 1906-1915 c. 8 Schedule C-Statutory Conditions at 1562.

The 1942 Insurance Act reads as follows:

> Life Insurance
> The contract of Insurance
>
> 208(1) Disclosure and misrepresentation by the insured. The applicant for a contract and the person whose life is to be insured shall each disclose to the insurer in the application for the contract, on the medical examination, if any, or in the statements or answers furnished in lieu of a medical examination every fact within his knowledge which is material to the contract, and a failure to disclose or misrepresentation of any such fact by either person shall render the contract voidable at the instance of the insurer.
>
> 209. Non-disclosure and misrepresentation by the insurer. A failure to disclose or misrepresentation of a fact material to the contract by the insurer shall render the contract avoidable at the instance of the insured:
>
> Provided that in the absence of fraud the contract shall not by reason of such failure to disclose or misrepresentation be voidable after the contract has been in force for two years during the lifetime of the person whose life is insured
>
> *Part VII*
> *Automobile Insurance*
>
> Voidance of policy of policy for misrepresentation, fraud or violation of condition.264 (1). Where an applicant for a contract falsely describes the automobile to be insured, to the prejudice of the insurer or knowingly misrepresents or fails to disclose in the application any fact required to be stated therein or where the insured violates any term or condition of the policy or commits any fraud, or makes any wilfully false statement with respect to a claim under the policy, any claim by the insured shall be rendered invalid and the right of the insured to recover indemnity shall be forfeited.
>
> *Fire Insurance*
> Schedule B(Section 195)
> Statutory Conditions
>
> Misrepresentation. 1. If any person applying for insurance falsely describes the property to the prejudice of the insurer, or misrepresents or fraudulently omits to communicate any circumstance which is material to be made known to the insurer in order to enable it to judge of the risk to be undertaken, the contract

shall be void as the property in respect of which the misrepresentation or omission is made.
Fraud. 16. Any fraud or wilfully statement in a statutory declaration, in relation to any of the above particulars, shall vitiate the claim of the person making declaration

Hail
Schedule F (Section 321)
Statutory Conditions

Misdescription or Misrepresentation. 1. Where an applicant in his application falsely describes the location and acreage of the crop, to the prejudice of the insurer, or knowingly misrepresents or fails to disclose in the application any fact required to be stated therein, the insurance shall be void as to the item of the application in respect of which the misdescription, misrepresentation or omission is made.
Fraud or False Statement. 11. Any fraud or wilfully false statement in a proof of loss shall vitiate the claim of the person making such proof of loss.[81]

In the Revised Statues of 1955, 1970 and 1980, the text of the law was maintained almost the same, with just a few changes in style.

The current legislation, passed in 1999, reads as follows:

Fire
549. Statutory Conditions.

Misrepresentation. 1. If any person applying for insurance falsely describes the property to the prejudice of the insurer, or misrepresents or *fraudulently* omits to communicate any circumstance which is material to be made known to the insurer in order to enable it to judge of the risk to be undertaken, the contract shall be void as to any property in relation to which the misrepresentation or omission is material.

Life Insurance.
567(1)Disclosure of material facts. An applicant for insurance and a person whose life is to be insured must each disclose to the insurer in the application, on a medical examination, if any, and in any written statements or answers furnished as evidence of insurability, every fact within the applicant's or

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[81] Act Respecting Insurance, R.S.A. 1942, c.201, ss. 208, 209, 195, 321.

> person's knowledge that is material to the insurance and is not so disclosed by the other.
>
> (2) Subject to section 568, a failure to disclose, or a misrepresentation of, such a fact renders the contract voidable by the insurer.
>
> 569. Non-disclosure and misrepresentation by insurer. If an insurer fails to disclose or misrepresents a fact material to the insurance, the contract is voidable by the insured, but in the absence of fraud the contract is not by reason of the failure or misrepresentation voidable after the contract has been in effect for 2 years.

Civil law, through the Insurance Act of Alberta and other provincial Acts,[82] has dealt with the problem of insurance fraud in an interesting way. From a first reading of the laws in the Insurance Act of Alberta, we can appreciate that fraud has in fact three different expressions: misrepresentation, misdescription and non-disclosure or omission, as *ways* to commit fraud. Furthermore, these three *expressions* of fraud have, at the same time, two categories: the intentional and the non-intentional. From these two categories, we have two different kinds of responsibilities, the civil and the criminal; the civil for those cases in which the three expressions already mentioned are committed without intention, and the criminal one in which criminal intention is present and the elements of ***actus rea*** and ***mens rea*** create the criminal liability. Therefore, the category of "fraud" was created in the Insurance Act to refer to "actual fraud," which carried criminal consequences after the criminal reform of 1948. The other laws – misrepresentation, misdescription and non-disclosure – are legal expressions of the same conduct but without criminal consequences.[83]

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[82] Almost all the provinces in Canada share the same approaches respecting misrepresentation, misdescription, non-disclosure and fraud. See, for instance : Ontario, Revised Statues, 1990, s. 148. British Columbia, Revised Statues, 1996, s. 119 and subsequent.

[83] Schmidt v. Home Insurance Company [1934]W.W.R. 187, Manitoba Court of Appeal. *Bowe v. Fire Ins. Co. Of Canada* [1936] 3 I.L.R. 430, Ontario Supreme Court.

4. The Canadian Courts' approach to insurance fraud.

After looking at more than eighty cases of insurance fraud over the last ten years throughout Canada, I feel that even though the problem of insurance fraud is reaching the courts, the courts have not developed a coherent jurisprudence concerning insurance fraud.[84] With the exception of cases such as *Theroux* and *Zlatic*, which I discussed above, for fraud cases other than insurance ones, there are no other important decisions in relation to the problem at the Supreme Court of Canada level.

Among the cases that have reached the Courts, both criminal and civil, civil cases have been the most common. It is important to underline that the cases sampled to analyze the response of the courts to the issue of insurance fraud were not chosen using statistical methods. From the eighty cases analyzed, it is possible to obtain the following observations.[85]

1. Criminal insurance fraud has been punished with prison terms which varied from 12 to 30 months and fines ranging from $6,000 to $30,000. Most of the sentences contemplated the necessity of public deterrence as a principal factor in the judgement. As Fradsham P.C.J. stated,

> I have no doubt that general deterrence is an important factor to be borne in

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Ginsberg v. New York Fire Insurance [1937] 4 O.L.R. 585, Ontario Supreme Court.

[84] *See* J.L. Bacher, "Le role des compagnies d'assurance en matiere de judiciarisation de la fraude"(The role of insurance companies in the judicialisation of fraud) (1995) 48 Revue International de Criminologie et de Police Technique at 326. This article, based on data extracted from court files, demonstrates that very few cases of insurance fraud reach the judicial process compared to the overall number of fraud cases. According to this study 70% of the insurance companies in Canada accepted the fact that they do not like to use the criminal justice system because of economical and practical considerations.

[85] The eighty cases reviewed are distributed as follows: Alberta 5 cases, British Columbia and Yukon 15, Saskatchewan 2, Manitoba 8, Ontario 17, New Brunswick 3, Nova Scotia 3, Newfoundland 4, Supreme Court of Canada 3, Federal Court of Canada- Trial Division 3.

> mind while crafting a sentence in this matter. The insurance industry relies very heavily on the good faith of policy holders when claims are submitted. The industry has limited means to detect and prevent fraud. It depends on the honesty of the consuming public and the proper enforcement of the applicable laws. There is no doubt that the provisions in the policy vitiating an entire claim if some of it is tainted fraud will provide some public deterrence. However, the criminal law cannot abdicate its general deterrence responsibilities because that contractual term exists. I agree with the Crown that a period of incarceration is required to send the message to the public that such activity (insurance fraud), though difficult to detect, will result in onerous consequences both in civil law and in the criminal law[86]

The same position was taken by Huband J.A. in the Manitoba Court of Appeal. As he stated, " we are of the view that a custodial sentence must be imposed in these circumstances where the trust which is integral to the insurance scheme has been betrayed."[87]

The Ontario Court of Justice has a similar position. As Caswell J. stated in *Rai*, "all three principles of general deterrence, specific deterrence and rehabilitation came into play in this case."[88]

As we can appreciate, the principle of *general and public deterrence* is becoming more and more important in cases of insurance fraud.

2. Insurance fraud is often discovered by coincidence in the course of investigations other crimes and in the development of civil cases. For example, in a case in Windsor, Ontario, a police officer looking in a residence for LSD found that the television in which he thought the LSD was hidden had been reported as stolen by its owner.[89]

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[86] *R.* v. *Goudreau*, [1992] A.J. No. 192 (Prov. Court) DRS 93.

[87] *R.*v. *Gaultier*, [1993] M.J. No. 247 (C.A.) DRS 94.

[88] *R.* v. *Rai*, [1996] O.J. No. 697 (C.A.) DRS 96.

[89] *R.*v. *Mousseau* [1994] O.J. NO. 2375 (Prov. Court) DRS 95.

In the same way, in the case of *R.* v. *Shoal,* [90] a police officer responding to a report of a car accident discovered that the accident was fictitious and the hidden intention was to commit insurance fraud. Unfortunately, in this case the judge characterized the case as involving mischief and the attempt to commit insurance fraud was ignored.

3. Canadian Courts are not convicting individuals for fraud because evidence to support convictions tends to be lacking. In fact, this is probably one of the most recurrent problems in the judicialization of fraud. In these cases, which represent about ten percent of our sample of cases, the fraud was, from the facts of the cases, apparently present. However, a lack of evidence resulted in a failure to convict.

In the case of *R.* v. *Pahn* [91], a case in Thunder Bay, Ontario, in which a couple was charged with damaging their restaurant with the intent to defraud their insurers, Kozak J. stated:

> After having considered all of the evidence, this Court has not been convinced beyond a reasonable doubt that this fire was non-accidental. The Crown has failed to prove beyond a reasonable doubt that this fire was intentionally set by the accused for the purpose of defrauding the insurance companies. Accordingly both accused are found to be not guilty as charged and acquittals are hereby entered.

A civil case does not use the beyond a reasonable doubt standard. In *Urscheler* v. *Algoma Mutual Insurance Co.*, Whalen J. ruled:

> Circumstantial evidence may satisfy the degree of probability required where fraud is alleged. Circumstantial evidence may also lead the trier of fact to the conclusion that the insured was, more probably than not, responsible for the loss claimed. While the direct and circumstantial evidence here may not yet

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[90] *R.* v. *Sohal* [1998] O.J. No. 2171 (C.A.) DRS 98.

[91] *R.* v. *Phan* [1996] O.J. No. 3959 (C.A.) DRS 97.

> comfortably meet the necessary standard, it is sufficient to discourage a conclusion that the Defendant cannot possibly succeed at trial, or that there are "spurious" issues of fact or credibility, or that it cannot survive " a good hard look." This is especially so where the evidence as to financial motive has not been fully developed and where it is necessary to observe the Plaintiff and other witnesses in order to assess what was "more probable than not." [92]

4. In civil cases, insurance fraud may be urged as one of the elements of claim, but the Court does not necessarily decide on the precise point of insurance fraud, and takes into account one of the other elements of the claim such as misrepresentation, misdescription or non-disclosure. In the case *Tritchie* v. *Groden*,[93] even though there was some basis for concern about fraud in the claim, it could not finally be proved. What the judge decided was to deny the payment, basing his sentence on the concept of non-disclosure.

The Newfoundland Supreme Court in *Bell* v. *Cooperator General Insurance Co.* dismissed the accusation of fraud because of the absence of certain evidence:

> This was an accident by the insured for indemnity under a motor vehicle insurance policy. The car owned by the plaintiff for one year had been hit with a hammer making it a total loss. The insurer claimed that the damages suggested deliberate destruction by the plaintiff or that the plaintiff connived at the damage so as to exclude coverage under the policy. The insurer had not discharged the onus of disproving the presumption that no crime was committed and proving that the plaintiff had connived at or damaged the car. While the damage was unusual given its intensity and apparent motiveless nature, the possibility of simple vandalism or motiveless destruction by a passerby existed.[94]

In many cases, the decision rests in the cancellation of the policy and the payment of money to replace the damages caused. To illustrate this situation, in the case *Shakor* v. *United*

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[92] *Urscheler* v. *Algoma Mutual Insurance Co.*, [1993] O.J. No. 1448 (C.A.).

[93] *Trotchie* v. *Gordon*, [1998] A.J. No. 444 (C.A.) DRS 98.

[94] *Bell* v. *Co-operators General Insurance Co.*, [1992] N.J. 52 (C.A.)DRS 93.

States Fidelity and Guaranty Co.,[95] an action for reimbursement under a fire insurance policy, the owner of a rental apartment was charged with arson. In his application for insurance, the owner did not reveal that he had cancelled a prior policy or that he had made prior claims despite questioning by the insurer on these issues. The policy stated that any fraud or wilfully false statement vitiated the claim, a position taken by Doyle J. under the concept of non-disclosure.

The last case that I am going to cite here in relation to the preferential treatment of fraud in civil cases is that of *Ford* v. *Dominion of Canada Insurance Co.*[96] in the Manitoba Court of Appeal. Arson was apparently present but because of the lack of evidence, it was turned into a non-disclosure responsibility with the voidance of the policy as a consequence. Huband J. stated:

> A contract of insurance is uberrima-fides; utmost good faith must be observed by both parties. It has been said that the relationship between an insurer and an insured is one in which the insurer knows nothing and the insured knows everything. This is the principle that De Graves J applied in arriving at this conclusion that Ford failed to make full disclosure of all material facts, and that, therefore, his policies of insurance were void . . .

This case is another example where, even though insurance fraud could be present, because of the lack of evidence and the difficulties of confronting the criminal matter, choices are made by the industry to pursue cases civilly rather than criminally.[97]

What we have learned in this Chapter could be summarized in two points. First, the number of insurance fraud criminal cases in the Canadian judicial system is, as far as our research goes, zero. Notwithstanding the criminal provisions that could be used to prosecute fraud, despite the fact they do not mention "insurance fraud" particularly, society evidently does not find in the criminal justice system a reliable method to confront the problem. Second, when parties decide to judicialize a case of insurance fraud, they choose the civil system instead of the criminal. The advantages for taking the civil option, already described, vary from the difficulty of obtaining evidence in the criminal process, to the cost of the criminal trial itself. For the purpose of our thesis statement, it demonstrates, once again, an insurance fraud decriminalization *de facto*.

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[95] *Shakor* v. *United States Fidelty and Guaranty Co.*, [1994] O.J. No. 460 (C.A.)DRS 95.

[96] *Ford* v. *Dominion of Canada General Insurance Co.*, [1989] M.J.No. 674 (C.A.) .

[97] *See Higgins* v. *Orion Insurnace Co.* 50 O.R. (2d) 352 , *Rak* v. *Saskatchewan Crop Insurance Corp.* [1989] S.J. No. 183 (Q.B.) No. 1145. *General Accident Indemnity Co* v. *Panache IV*, [1998] 2 F.C. 455 (C.A.); *Moscarelli* v. *Aetna Life Insurance Company of Canada* [1995] O.J. No. 1709.

Chapter Three

The English Perspective.

In this chapter I will deal with the English approach to insurance fraud, from both (1) criminal and (2) civil perspectives, as well as (3) in the English fraud cases. The intent of this chapter is to state how for the English conception, insurance fraud is not considered a criminal offence unless it is committed in connection with a conspiracy. England, as the pioneer of the concept of insurance in the modern world,[98] serves very well as an historic reference concerning how the legal tradition has treated the problem of fraud.

1. Fraud as a Criminal Offence.

The offence of fraud still does not exist in England. It is surprising that the country in which insurance was born in its modern form around four centuries ago[99] lacks a *specific offence* of insurance fraud, as well as a *substantive offence* of fraud in general.

Before 1757, when the offence of false pretences was created, the common law recognized the offence of conspiracy to defraud. Paraphrasing Ewart, the common law in

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[98] "Historians believe that a rudimentary form of insurance may have existed in China as early as 5000 BC. There, boat operators found it advantageous to redistribute their cargoes to several boats as they approached treacherous rapids on their rivers. If one boat was lost, all the boat owners shared the loss and no one was wiped out. The Code of Hamurabi, written around 2000 BC by the Babylonian emperor, gave the world the principle of indemnity. In 1310, the first commercial insurance company was founded by the Duke of Flanders. **The earliest policy issued by Lloyd's of London is believed to have been signed in 1613.** In Canada, the Phoenix Assurance Company Limited of London was established in Montreal in 1804. The first completely Canadian company was established in 1809 in Halifax, and became The Halifax Insurance Company in 1819", in "Facts of the General Insurance Industry in Canada", Insurance Bureau of Canada, (Toronto: 1997) at 12.

[99] J.Birds, *Modern Insurance Law* (London: Sweet and Maxwell, 1997) at 121.

England took the view that although a conspiracy to defraud was a criminal offence, one person's ability to trick another was of no public concern, and would not constitute a substantive criminal offence. The exception, according to Ewart, was trickery by the use of false measures, which appears to have been made a crime because it represented a risk to the public. The law of conspiracy to defraud "emphasized the general rule that individuals were expected to take whatever measures were necessary to prevent their being cheated by another individual."[100]

It was stated by the House of Lords in *Scott v. Metropolitan Police Comr*[101] that:

> ...it is clearly the law that an agreement by two or more by dishonesty to deprive a person of something which is his or to which he is or would be or might be entitled and an agreement by two or more by dishonesty to injure some proprietary right of his, suffices to constitute the offence of conspiracy to defraud.

The general approach of the law, as indicated by Ewart, is reflected in the statement of Holt C.J. in *R.*v. *Jones*:[102]

"Shall we indict one man for making a fool of another?"

In England, as in Canada before the amendment of the Criminal Code in 1948, fraud was of public concern – meaning an issue of a criminal concern – only when committed in connection with a conspiracy. Fraud was not the criminal justice system's concern when it was committed between two equal individuals in the absence of trickery by the use of false measures, this latter case of fraud being a risk to society in general:

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[100] Ewart, *supra* note 8 at 7.

[101] [1975] AC 819, [1974] 3 All ER 1032.

[102] (1703), 3 Ld. Raym. 1013, 92 E.R. 174.

> The net result was that although a deceptive device or artifice, other than a false pretense, would become the serious criminal offence of conspiracy if two or more agreed together to practice it, it was perfectly lawful if practised by one individual on another.[103]

However, after treatment given by the common law to the substantive offence of conspiracy to defraud, in 1757 the *Statute of False Pretenses* was created, which defined the particular offence of "false pretenses" in order to supplement the common law.[104] It is possible to argue that the offence of "false pretences" is no less than the offence of fraud itself, yet it has not been recognized in this way by the current scholars of fraud. The Statute of False Pretenses, according to the introductory text of the Statute, was enacted for the

> more effectual punishment of persons who shall attain, or attempt to attain, possession of goods or money, by false or untrue pretences; for preventing the unlawful pawning of goods; for the easy redemption of goods pawned; and for preventing gaming in publick houses by journeymen, labourers, servants and apprentices. [105]

According to Nightingale and Ewart, the criminalization of fraud in the public law domain in common law was dominated by the principles of contracts and the concept of *caveat emptor*, a "doctrine that holds the purchasers buy at their own risk."[106] In other words, the concept of fraud, and the possibilities of prosecuting fraudulent activities, was related to the common law rules of commerce and commercial practices and, in particular, with two specific offences. The first previously mentioned one, is the offence of ***trickery*** by the use of false measures; it occurs when a person cannot protect himself from an outright lie [107]. The second is the offence of ***conspiracy to defraud***, which occurs when an individual cannot protect himself from the fraudulent acts of two or more persons acting in concert.

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[103] *Ewart*, *supra* note 8, at 7

[104] The Statute of False Pretenses, 1757 (30 Geo.2, c.24) was created, according to Ewart (*supra* note 8) 48, to " supplement the substantive offence of theft and the common law inchoate offence of conspiracy to defraud."

[105] The Statutes at Large from the 30th to the 33rd year of the King George II, Cambridge, 1766, at 114.

[106] *Supra* note 54 at 215

In 1968, the offence of Obtaining Property by Deception was included in the Theft Act of 1968. This criminal law, although not called *fraud*, serves the same function, addressing the problem of fraud

Section 15 (1) of the 1968 Act provides:

> (1) A person who by any deception or dishonesty obtains property belonging to another, with the intention of permanently depriving the other of it, shall on conviction on indictment is liable to imprisonment for a term not exceeding ten years.

Here we see then the legal tool to deal with those individuals who commit fraud in the absence of conspiracy, that is, just by themselves. Is it not then a clear law to combat fraud in cases of sole individuals, in contrast to what the authors say in respect to this?

After 1968, the Criminal Law Act of 1977 provided the legal instruments to convict a person who, as the law says "agrees with any other person or persons that a course of conduct is to be pursued, if the agreement is carried out in accordance with their intentions..." The law of conspiracy is clear, but is to conspire what crime exactly, is it fraud? Certainly yes, but unfortunately it is not a crime under the British laws. In this case, what the English authors and the legal culture have developed is an automatic link to the offence of *conspiracy*

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[107] Nightingale, *supra*, note 10, at 2-2.

to obtain money by deception (the same as fraud, but under a different name), with the hope of alleviating the non existence of a fraud offence.

Furthermore, after 1977, the Criminal Justice Act of 1987 presents us the particular offence of *conspiracy to defraud*, now at the level of statute rather than common law. This offence of *conspiracy to defraud* gives the opportunity to prosecute people with a maximum period of imprisonment not exceeding 10 years.

It says,

> (1) If
> (a) a person agrees with any other person or persons that a course or conduct shall be pursued; and
> (b) that course of conduct will necessarily amount to or involve the commission of any offence by one or more of the parties to the agreement if the agreement is carried out in accordance with their intention . . .

Under the Criminal Law, the authors refer us to the law of conspiracy to defraud, and continuously say that it is indeed the only way to prosecute people; "although there is no English offence akin to the Canadian substantive offence, the common law offence of *conspiracy* to defraud accomplished a similar end for well over 200 years."[108]

The application of Section 1, Part one of the Criminal Law Act of 1977, conspiracy, in the case of fraud, is just the natural application of a situation of conspiracy, possible in every single crime, to the offence of *obtaining money by deception* under the Theft Act.

However, the Criminal Justice Act of 1987 deals with the same topic, introducing the substantive offence of conspiracy to defraud, being more careful in this treatment of the problem. As Lord Roskill said, " because there is no substantive offence of conspiracy to defraud, with the sustained, serious, collective dishonesty which that involves, substantial injustices arise."

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[108] Ewart, *supra* note 8 at 4.

The offence of *conspiracy to defraud* reads as follows,

> Conspiracy to defraud
> 12 Charges of and penalty for conspiracy to defraud
>
> > (1) If--
> > (a) a person agrees with any other person or persons that a course of conduct shall be pursued; and
> > (b) that course of conduct will necessarily amount to or involve the commission of any offence or offences by one or more of the parties to the agreement if the agreement is carried out in accordance with their intentions,the fact that it will do so shall not preclude a charge of conspiracy to defraud being brought against any of them in respect of the agreement.
> > (2)...
> > (3) A person guilty of conspiracy to defraud is liable on conviction on indictment imprisonment for a term not exceeding 10 years or a fine or both.[109]

Taking into account notes contained in Halsbury's Laws of England, we can appreciate the negative reaction of some members of the government in relation to this offence and the absence of a substantive fraud offence. As the Minister of State for the Home Office said in the Standing Committee debate on the provision now contained in the offence known as a Conspiracy to Defraud, this law had

> two very damaging effects. First, in some major fraud cases, the prosecution has had to rely on relatively minor charges which carry correspondingly low penalties; and, secondly, juries have had to face needlessly complicated trials, either because numerous small charges were brought in a case, or because part of the way through a trial on a charge of conspiracy to defraud, facts emerged which obliged the charge to be dropped and replaced by others. Because there is no substantive offence of conspiracy to defraud, with the sustained, serious, collective dishonesty, which that involves, substantial

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[109] *Halsbury's Statues*, 4th ed., v.12 (London: Butterworths 1997 Reissue) at 1008.

injustices arise."[110]

Lord Roskill, chairman of the Fraud Trials Committee,[111] commented on the problem in the following terms:

> In many fraud cases a charge of a substantive offence or of a statutory conspiracy to commit a substantive offence will be entirely appropriate and the maximum penalties adequate. In some cases, however, the only substantive offence available may be a relatively minor offence carrying low penalty or a series of minor offences, or an offence or offences which are perhaps only incidental to the fraud. In these circumstances, the prosecution may find it impossible to prosecute for offences, which reflect the totality and gravity of the allegedly fraudulent conduct in what would otherwise be called conspiracy to defraud.[112]

In relation to insurance fraud, we can deduce that it is perfectly possible to prosecute a case of insurance fraud when it is committed by the use of a conspiracy to defraud. In other words, when insurance fraud is committed or planned by more than one person in concealment, there is the possibility of finding a criminal way to punish the behavior. What happens, however, in the case of insurance fraud when it is committed by one person as a substantive offence? There is no possibility of prosecution for fraud; hence, it is only possible to convict the person using other minor or related offences such as falsification.

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[110] Halsbury's Statues, *supra*, note 108 at 1010.

[111] The purpose of this committee, according to its terms of reference, was "to consider in what ways the conduct of criminal proceedings in England and Wales arising from fraud can be improved, and to consider what changes in existing law and procedure would be desirable to secure the just, expeditious and economical disposal of such proceedings"; M. Levi, "Fraud Trials Perspective" (1984) 12 The Criminal Law Review at 384 - 396

[112] Halsbury's Statues, *supra*, note 116, at 1011.

2. Fraud within Civil Jurisdiction.

Remedies for fraud were first recognized by the ancient heads of equity jurisdiction, the Courts of Chancery, the Courts of Requests and the Star Chamber, all of which were responsible for resolving disputes in relation to all type of frauds for which there was no remedy in common law.[113] In the late 18th century[114] the common law first recognized the concept of fraud with the development of the tort of deceit.[115] However, it was not until the 19th century that common law created the rules that we now know and use for the termination of contracts on the grounds of fraud.[116]

For our purposes, it is interesting to note that in the private law domain, since the time of the heads of equity jurisdictions, general fraud rules have been contemplated. Even though the cases through which the doctrines of fraud developed severally involved the sale of goods, the concept of fraud was also accessible for cases in which insurance was involved.

However, to control insurance fraud in particular, and perhaps to prevent it, English civil insurance legislation has provisions concerning fraud.

The first mention of fraud in the current English civil insurance legislation is under the heading Avoidance of Policy, which reads as follows:

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[113] Nightingale, *supra* note 10, at 1-15.

[114] According to Birds, *supra* note 101, it was not until the mid-eighteen century, with the appointment of Lord Mansfield as Lord Chief of Justice, that the common law courts took an interest in insurance contracts.

[115] L. Holdsworth, *History of English Law*, Vol.5 at 2920-3; in Nightingale, *supra* note 10 at 1-21.

[116] Even though some authors such as Campbell refer us to the times of Joseph in the ancient Egypt, and the Greeks and Romans as the times and places where insurance and insurance crime were born, the earliest reported cases of fraud in the English tradition were: *Brown v. Will at E.* [1397], 42 Ass. Pl. 8.; *Dale's Case* [1585], Cro. Eliz. 44,78 E.R. 308 (K.B.); *Medina v. Stoughton* [1699], 91 E.R. 188, 1297, Salk. 210, 1 Ld. Raym. 593. Nightingale, *supra* note 10 at 1-2.

> (9) Avoidance of Policy
> (I) Fraud, Concealment or Non-disclosure
>
> 215. Effect of fraud on policy. A contract of marine insurance, *like any other contract*, is voidable on the ground of fraud, and any fraudulent misrepresentation made in order to induce the insurer to enter into the contract entitles him to avoid the policy, unless it is proved either that he knew the true states of the facts at the time of contracting or that he did not rely on the misrepresentation. Independently, however, of fraud, a misrepresentation as to material facts, or a nondisclosure of material facts, may entitle the insurer to avoid the contract. (italics added)
>
> (15) Recovery of losses and return of premiums
>
> 334. Effect of fraud or illegality. Where the insurer has been induced to enter into the contract of insurance by the fraud of the assured or his agent, or where there has been illegality on the part of the assured, and the policy is avoided by the insurer, the assured cannot recover the premium. On the other hand, where the assured has been induced to enter into the contract by the insurer's fraud, and consequently repudiates the contract, the premium must be returned. (...)
>
> (9) Claims under policies
>
> (iv) Fraudulent claims
>
> 492. Effect of fraudulent claims. The making of a fraudulent claim is a breach of the duty of good faith and consequently the assured forfeits all benefit under the policy, whether it contains an express condition to that effect or not. Policies of non-marine insurance usually contain an express condition against fraudulent claims. The insurers are not entitled to recover as damages the expenses incurred in investigating a fraudulent claim.

With these pieces of legislation, England has solved in part the treatment of insurance fraud. The effects of a fraud, misrepresentation, misdescription or omission, either with intention or not, are framed in the context of civil liability.[117]

3. English Fraud Cases. Fraudulent situations vs. conspiracy to defraud and conspiracy to obtain money by deception.

To discover the leading English insurance fraud cases, I used electronic and paper-based sources covering the period from the 1700's until December 2000.[118] However, even though the headings used to develop the search for cases have been many, from the sole word *insurance* and including phrases such as *insurance fraud*, *insurance crimes*, etc., not many cases have actually appeared. Despite that, the judicial decisions that I am going to refer to are cited in the most important text books concerning insurance and criminal law on the topic of fraud in the United Kingdom and are quoted in the most important decisions, being then considered leading cases on the topic.

Insurance fraud cases are civil cases. In other words, fraud is used by insurers to cancel policies and consequently to deny claims.[119] Even though many cases provided apparently clear bases for criminal proceedings, to my knowledge, no criminal charges were laid, and no reported criminal convictions were entered.

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[117] The opinion of the industry in relation to the legal status of the problem is well expressed in the words of John Wagstaff, director of the Insurance Crime Bureau of the Association of the British Insurers, as follows: "There is no legal definition of fraud in Great Britain. To some, it is not considered a true crime. Of course, it all depends on whom you ask. A claims manager will consider a number of attitudes to be fraudulent, but this is not the case of everyone. Insurers therefore do not systematically resort to the law. In many cases, fraud is simply considered the act of seeking minor financial gain and is not seen as a true crime. In the United States, the problem of fraud is taken much more into consideration. Indeed, new legislation has made fraud prosecution more easy. We will have to wait a while to see the Great Britain take similar measures:" J. Wagstaff, "Insurance Fraud in Great Britain" in SCOR-TEC, *Fraud in Life and Non-Life Insurnace in Europe* (Paris, 1996) at 6.

[118] Among the sources are the English Law Reports, Lloyd's List Law Reports, The Times Commercial Cases, The Times Law Reports and the electronic databases Lexus and West Law.

[119] It is not necessary that the policy actually contain a special clause in relation to fraud to recognize fraud as a basis for voiding the contract and denying the claim.

In the case *Herman* v. *Phoenix Assurance Co. Ltd.*,[120] despite the fact that the company could clearly establish fraudulent concealment and misrepresentation, which as a consequence disentitled the insured to the claim according to the policy terms, there was no independent prosecution of the insured. The facts of the case clearly indicate the existence of a conspiracy to obtain money by deception under section 1 of 1968 Act.[121] The judge recognized the presence of fraud in the phrase " the claim has to be dismissed because Mr. Herman would have failed on misrepresentation if he had not failed on fraud."[122] The central point of the decision was to deny the claim and to emphasize the fact of misrepresentation. The judge stated that " if you go to insure general merchandise and know that two thirds of the value insured are furs of a very valuable nature, you are guilty of concealment if you say nothing to the underwriter except that it is general merchandise."[123] What we have then is, *de facto*, civil law creating civil consequences when to my eyes there is a clear criminal conduct to be prosecuted.

In *Herbert v. Poland*,[124] the case is even more clear. It was proved that a bungalow was set on fire as a result of an agreement between two parties. The judge said, "whether he was a party to the conspiracy or was not I do not know, but that there was a conspiracy to burn down this house I have not the slightest shadow of a doubt."[125] He continued, "I can come to no other conclusion than that these premises were deliberately set on fire, and deliberately set on fire as the result of agreement between those two parties at least."[126] In consequence, the policy was voided and naturally the claim dismissed. Again, this was a perfect case to prosecute for concealment to defraud, but no such prosecution followed.

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[120] *Herman v. Phoenix Assurance Co. Ltd.* (1928), 18 LL.L. Rep, 371 (C.A.)

[121] S.15 (1) of the 1968 Act.

[122] *Ibid.* at 372.

[123] *Ibid.* at 372.

[124] *Herbert v Poland* (1932), 44 LL.L. Rep 139(Q.B.)

In *Shoot v. Hill*,[127] where evidence for a claim was considered fraudulent, the judge stated, " those are the reasons which have led me to conclude that this is from beginning to end a fraudulent claim." As in the other cases, the challenge in this case was to determine whether the case fit the terms of misrepresentation, non-disclosure or misdescription and their grades of fraud.

In *London Assurance v. Clare* and others,[128] the English courts reached a very interesting position that also is also beginning to be shared by the Canadian judicial system.[129] The excessive amount of a claim is not necessarily proof of fraud. This means that when a claim is presented to the insurance company and the price for the claim has been inflated, the insured simply wants to negotiate with the company to reach a fair price of the claim. Even though this is probably the most important part of the decision, in this particular case, the claim was so exaggerated that it had to be considered fraud by the judge. Once again the judge decided that it was indeed a fraudulent case by proceeding to deny it. There is no evidence that a criminal prosecution was undertaken later.

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[125] *Ibid.* at 145

[126] *Ibid.* at 145

[127] *Shoot v. Hill* (1936), 55 LL.L. Rep 29 (Q.B.)

[128] *London Assurance v. Clare* (1937), 57 LL.L. Rep 254.

[129] "Most problems of analysis, however, arise where the allegation of fraud concerns the statement of value placed on the loss by the insured. Clearly, where a claim is found to have been inflated deliberately, there is fraud. While the onus of proving fraud in such cases strictly remains on the insurer, the courts have repeatedly held that gross overvaluation creates a presumption of fraud. ***However, if the court is satisfied that the insured was honestly mistaken in stating the amount of claim, the claim will not be vitiated and the insurer will be liable for the actual amount of loss [my emphasis].*** C.Brown and J.Meneses, *Insurance Law in Canada*, (Toronto: Carswell, 1982) at 229.

What we have learned from the previous Chapter could be summarized in two points. First, the English law is not clear in dealing with fraud. The first observation from this fact is that the offence of fraud does not exist, neither specifically for insurance, nor for fraud in general. At common law and in statute, English law contemplates the offences of conspiracy to defraud, false pretenses, and obtaining property by deception. The natural conclusion from these observations is that the English law is, as the community of insures recognize in England, not suitable for criminal prosecutions of fraud, and, as we will see in Chapter Six, some English groups advocate the clarification of the law, as well as the creation of a specific insurance fraud offence. The second point, is that the community involved in the business of insurance prefer, when judicializing the problem, to use the civil system instead of the confused criminal one. Once again, and for the purposes of this thesis, an insurance fraud decriminalization *de facto* takes place.

In the next Chapter I shall enter to describe the actual treatment of insurance fraud by the criminal dispositions in the United States of America.

Chapter Four

The American Perspective

In this Chapter I shall describe the means employed in the United States to combat insurance fraud. I will examine the criminal law treatment of insurance fraud at (1) the federal level; and (2) the state levels, with regard to the laws of California, New York and Delaware.

1. The United States of America and the legal fight against insurance fraud.

The purpose of analysing the American approach in the fight against insurance fraud, in both the federal laws and the states' laws, in comparison with the Canadian and the English legislation, is to reach a conclusion in relation to which of these systems, if any, is best, and to complete the panorama of the legal possibilities of approach in relation to the fight against insurance fraud.

1.1. Federal fraud treatment.

On the federal level, the United States does not have any specific offence related to insurance fraud. Insurance fraud can be prosecuted by the federal law of the United States only if the crime is committed using the the national postal service or if it affects interstate commerce.[130] The purpose of the mail fraud statute is to "prevent the Post Office from being used to carry into effect schemes to defraud, and the statute includes a broad proscription of behaviour for the purpose of protecting society."[131] However, the offence was not created to fight against fraud itself, but to prevent the misuse of the mail service.

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[130] The following extracts are taken from the comments of the United States Code Service. "Predecessor to SCS *1341 did not purport to reach all frauds, but only those limited instances in which use of mails was integrated part of execution" in Kann v. United States (1944) 323 US 88,89 L Ed 88, 65 S Ct 148, 157 ALR 406. "Where insurance agent presented to proper by official false death certificate, which was approved by official without knowledge of fraud and placed in mail addressed to home office, agent caused mailing of false certificate:" *United States* v. *Kenofskey* (1917) 243 US

The other federal law in relation to insurance fraud concerns fraud offences committed by or affecting persons engaged in the business of insurance whose activities affect interstate commerce.[132] Once again, the law deals with insurance fraud collaterally rather than directly.

All the specific legislation about insurance fraud and fraud in general has been developed by individual states.[133]

1.2. State legislation.

Almost every state of the United States has legislation that in one way or another

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440, 61 L Ed 826, 37 S Ct 438. "Mailing of false Proof of Loss statement to insurance company after check for false claim has been delivered forms basis for violation of USC s: 1341:" United States v. Ledesma (1980, CA7 I11) 632 F2d 670. U.S.C.*1341-S, 245, 295,307).

[131] U.S.C.S. *1341 (Lawyers Cooperative 1996).

[132] U.S.C.S. *1031 (Lawyers Cooperative 1996).

[133] L. Mazurca, "State Track Insurance Fraud as the Crime is on the Rise" (Jan.2, 1988) 34 Agent Borkers Topics at 34 D. Some of the states that have special Fraud Units to combat fraud claims are: Alaska (Alaska Stat *21.06.080 (c) (1991) (giving the insurance department broad powers to investigate any alleged violations, such as claims fraud) & * 21.36.390 (c) (1991) (stating that the insurance departament's director "shall investigate facts... and shall refer... to the appropriate prosecutor" insurance law violations, which include claim fraud)); California (Cal. Ins. Code **1872 - 1872.9 (West 1992) (created in 1978); Florida (Fla. Stat. Ch. 626.989 (1991) (created in 1976); Georgia (Ga. Code Ann. * 33-2-3 (1992) - providing the state insurance commissioner with broad powers to create departments - a Fraud Unit, within the Insurance Commission's Enforcement Division, was created in 1991; Idaho (Idaho Code ** 41-250 & 41-252 (1991) (creatd in 1980. A two-person claims fraud bureau within the Department of Insurance; Nevada (Nev. Rev. Stat. ** 679B. 154 - 155 (1991) (established in 1993); New Jersey (N.J. Stat. Ann. * 17:33 a-8 (1985 and sup. 1991) (created in 1983)): New York (N.Y. Ins. Law. **401-402 (McKinney 1985) (created in 1981)); North Carolina (N.C. Gen. Stat. *58-2-160 (1991); Ohio (established in 1985; created in a budget item, no special enabling statue); Pennsylvania (part of the Enforcement Bureau at the Pennsylvania Insurance Department; Texas (Tex. Ins. Code art. 1.10D (West 1992) (created in 1991).

directly attempts to combat fraud. Every state, sometimes following the guidelines proposed by the Coalition Against Insurance Fraud,[134] and sometimes on there own initiative, has developed precise and concrete pieces of legislation both in the criminal and the civil context.

The treatment that the states have given to the problem demonstrates two clear ways to approach insurance fraud, the "punishment" view that believes in criminal prosecution in order to control and possibly eliminate the problem, and the civil view that promotes in depth research of the problem, contemplates civil venues to solve the conflict, and encourages the role of the insurance companies in the direct solution of the problem.

In the following section, I will analyse the fraud legislation in the states of California, New York and Delaware as good examples of legislation that contain precise references to insurance fraud from both the civil and the criminal perspectives.[135]

1.2.1. State of California.

Besides the general civil provisions concerning misdescription, non-disclosure and misrepresentation that naturally void the payment of the insurance claim, what is interesting in California is the creation of the Bureau of Fraudulent Claims, added to the statues in

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[134] One of the purposes of the Coalition in the United States is to promote the enactment of new laws and regulations that directly and indirectly prevent, deter or help detect insurance fraud, and seek appropriate remedies, including restitution and license revocation, against those who commit fraud. Such initiatives must be cost-effective and practical. The Coalition seeks to communicate the scope of the fraud problem and potential solutions to all major audiences in order to increase awareness, provide deterrence, change attitudes and build support for the Coalition's initiatives. It also serves as a clearinghouse of insurance fraud information, and conducts research to enable the Coalition and policymakers to make more informed decisions on how to combat insurance fraud effectively and efficiently. Online : www.insurancefraud.org.

[135] I chose these States because of their population and the importance they represent in the business of insurance. The headquarters of the main U.S. insurance companies are located in these three states, and the majority of the insured population is located in these areas.

1978.[136] The purpose of this Bureau is to help the insurance industry in the control of fraud, to guide investigations of fraud cases and to help with the disclosure of information from the enforcement agencies of the state. However, the Insurance Code of California also applies to fraud when it is committed by brokers, agents, solicitors and adjusters. Remedies include reporting to the criminal authorities or the suspension of licensed activities in the case of brokers, agents, solicitors and adjusters.

In brief, what the Insurance Code in California tries to do is to regulate insurance fraud perpetrated by almost all the participants in the business of insurance. The purpose of the Bureau is then to represent the interests of society by promoting honesty in the insurance business.

This Insurance Code, even though it refers in certain cases to the criminal responsibility of the defrauder, has a civil perspective on the problem and usually contemplates civil treatments of the problem such as the control of the fraudulent activity through the Bureau of Fraudulent Claims.

In the context of penal law, California has probably one of the oldest pieces of legislation against insurance fraud in North America. In 1872, the California Penal Code established the offence today known as "Defrauding or prejudicing insurer."[137] This offence specifies some ways by which fraud can be committed. The section reads as follows:

> s.548.Every person who wilfully injures, destroys, secretes, abandons, or disposes of any property which at the time is insured against loss or damage by theft, or embezzlement, or any casualty with intent to defraud or prejudice

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[136] Insurance Code of California, *12990-12997 (West 1988).

[137] *Penal Code of California*, c.10, s.548 (West 1988).

the insurer . . .

Indeed, the section specifies in detail some of the forms to defraud an insurance company and establishes a punishment of two, three, or five years, as well as a fine not exceeding fifty thousand dollars. The Penal Code, in its treatment of insurance fraud, does not stop with this offence. It continues establishing a list of offences related to insurance fraud, attempting to cover every possibility.[138]

1.2.2. State of New York.

New York also has the civil laws of misrepresentation, non-disclosure, and misrepresentation to avoid the payments of claims. As well, New York has an Insurance Prevention Act through which the Insurance Fraud Bureau was created in 1971. The purpose of this Bureau is, in general, " [to] discover insurance frauds, halt fraudulent activities and receive and receive assistance from federal and state law enforcement agencies in the prosecution of persons who are parties to insurance frauds."[139] The penal law of the State of New York contains a specific insurance fraud offence.[140] The purpose of this legislation, according to the then Governor of New York, is to indicate that "the State will no longer tolerate crime in the insurance field, and should encourage the prosecution of such crimes."[141]

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[138] *Penal Code of California*, c.10 s.549, false or fraudulent claims against insurers; solicitation, acceptance or referral of business. s.550, false or fraudulent claims or statements.

[139] New York Laws Ann. *402 (West. 1985)

[140] New York Laws Ann. *176.00 (West. 1985)

[141] New York Laws Ann. Governor's Approval Memorandum, 1981 at 2617-18.

Sections 176.00 - 176.35 of the Penal Code of New York apply to insurance fraud in a range of degrees, from fifth to first degree, depending on the monetary amount of the fraud. The detailing of the offence, the inclusion of degrees and the aggravated form of the crime indicate that the legislator is convinced of the positive effect of the criminal judicial method in the treatment of the problem.

In the case of New York we have a clear example of the aggressive political economy of crime in relation with insurance fraud. Both the civil laws through the insurance law and the criminal laws through the Penal Code includes instruments to fight the problem through criminal or criminal related ways.

1.2.3. State of Delaware.

Chapter 24 of the Delaware Statues is the Delaware Insurance Fraud Prevention Act. The purpose of this Act, as the legislator itself states, is to "confront aggressively the problem of insurance fraud in the State by facilitating the detection of insurance fraud, reducing the occurrence of such fraud through administrative enforcement and deterrence, requiring the restitution of fraudulently obtained insurance benefits and reducing the amount of premium dollars used to pay fraudulent claims."[142]

With the creation of this chapter, the state of Delaware is underlining the importance of insurance fraud, given its careful definition and treatment of insurance fraud.

Criminal laws in this State also contemplate the specific law of insurance fraud.

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[142] *Delaware Insurance Code*, *2402 (Michie, 1998)

Section 913 of Delaware Criminal Code[143] describes insurance fraud as a specific offence.

In brief, the American legislation at both the federal and state level, is rich in legislative actions against the concrete offence of insurance fraud.

The approach of the United States is different from the English and the Canadian in the sense that the approach the States have attempted to be very specific is describing the proscribed conduct, up to the point of creating, by law, specialized state offices to deal with the prevention, control and prosecution of insurance fraud. However, a simple observation of the American statistics demonstrates that no matter the specific treatment given to the problem, the cost and prevalence of insurance fraud is growing as a consequence of the nature of the crime, a crime of greed that perhaps is impossible to stop in the near future.

Having described the American mechanisms for dealing with insurance fraud, and its detailed legislation both in the federal and the state level, I shall describe the way insurance companies are dealing with the problem by their own, choosing not to proceed with the criminal option, and being more pro-active in an independent manner to control the problem.

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[143] *Ibid.* *913

Chapter Five

In this Chapter I shall describe the responses from the insurance industry in dealing with insurance fraud, and how insurers do not use the criminal law and prefer, instead, the civil law and their own methods to prevent, detect and control the problem.

Introduction.

In Colombia, the place where I have done my previous research, the concern about fraud really began in 1995 when a process was started in order to define fraudulent activity. At that time, the first goal was to know the exact cost of fraud and its specific characteristics among Colombian insurance companies. Unfortunately, even today the exact amount has not been determined and a complete view of the problem has not been finished. However, the principle contribution of that research was to point out the terrible weakness of the industry in relation to the offence.[144] As a consequence, during 1996 and 1997, 44% of all insurance companies in Colombia started monitoring the problem and designing their own models of prevention and detection. International companies that have businesses in Colombia such as Mapfre (Spain), Chubb (England), Liberty Mutual (United States) and Skandia (Scandinavia) among others, have specific manuals that provide structured knowledge of the problem from the international experience. However, the important point to make here is that all efforts from companies to combat fraud are similar in the following respects:

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[144] Cabrera Castillo y Asociados, Jorge Eduardo Cabrera, *Fraude en Seguros en Colombia*, Publication of the National Insurance Federation, 1996, *Fraud Indicator System*, FASECOLDA, 1998.

- ***Lack of reliance on the criminal justice system.***
- ***Extra-legal description of the conduct (specific manuals that describe the offence).***
- ***Fraud detection mechanisms (known as IFS, Indicator Fraud Systems).***
- ***Punishing mechanisms (cancellation of policies, ostracism, etc).***
- ***Prevention mechanisms (contests among employees, public campaigns, etc).***

In brief, the problem has been recognized as a reality and objective actions for its control have been developed.

1. Insurance Fraud and Criminal Law: The anti-fraud technique known as criminal law.

The moral view of insurance fraud on the part of insurance companies seems to be divided in two categories. The first is characterized by those companies among the industry that want to fight it using criminal and civil justice solutions. The other group of companies also wants to combat the phenomenon, but their actions are in favour of private solutions, mainly using instead mediation with the client to reach an agreement in relation to the "fraudulent situation." I will call the first category the "pro-judicial solution" and the second the "pro-direct solution" to the problem.

We cannot count how many and which insurance companies in particular are in what category. All of them seem, at first sight, to be in the first. Of course, among industry peers, it is better to show a concrete, strong position against insurance fraud. Insurers, however, have good reasons not to employ "pro-judicial solutions."

It is not in the commercial interests of an insurer to publicly declare that every insured person who commits or intends to commits fraud will be prosecuted according to the criminal law, and the case will be brought to its final consequences. Many potential clients of the company will go to a competitor where they know fraud is not going to be treated in such a strong way. The experience in reality is clear.

According to John Wagstaff, Director of the Fraud and Crime Prevention Bureau of the Association of British Insurers,[145] the fact is that insurance companies rarely present a case for criminal prosecution. The normal judicial procedure, when it is used, (which is also very rare) is the civil one, claiming cases of misrepresentation, misdescription, non-disclosure or the price of the claim.

However, even though there have been only a small number of criminal prosecutions for insurance fraud, for our academic analysis some of the keys to a successful prosecution are, first, a real desire on the part of the insurance industry to prosecute the crime. What happens in reality is that insurance companies do not cooperate with the prosecution because of their belief that, paraphrasing Michael Clarke, ***it is better to get an agreement with the insured than to go through a judicial process***.[146]

The presentation of a criminal case, according to Wagstaff, is avoided by the companies for many reasons, including the cost and the time expended on the case, and the lack of technical knowledge of the prosecutors, judges and counsel. Furthermore, the evidence of fraud is, in most cases, very difficult to get. In general, defrauders are very careful in the commission of the crime, and because of the nature of the contract, ***uberrima fides*** or utmost ***good faith,*** it can be classified as an "easy" offence in terms of its social impact in comparison to crimes such as homicide and rape. For instance, it is extremely difficult to know the truth when an insured reports a radio car theft or even a collision. The only proof, in the majority of the cases, is the word of the insured. There is no more evidence than the testimony of the victim if we consider that it is common to forget to close a car's door or window or that many thieves are experts in opening locks without leaving any trace. Hence, even for serious cases of frauds such as those involving marine insurance policies or construction liability, the proof of fraud, with the onus on the insurer, is extremely difficult to make. Another reason for this lack of reporting relates to the image of the company. A declared fight against fraud could put off clients who consider an open fight against fraud an obstacle for rapid indemnity payments.

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[145] Personal informal interview in London, England, August 8, 2000.

[146] M. Clarke, "The Control of Insurance Fraud" (1990) 30 The British Journal of Criminology at 13.

Insurance companies use the judicial method only in cases in which a large amount of money is involved and in which the reality of fraud cannot be ignored.[147] In other words, it seems that the *secret policy* in some companies is to permit certain kinds of minor fraud, cases that they do not call fraud,[148] and to denounce those cases where the amount is large or the evidence is rampant.

However, I do not want to state that insurance companies are accomplices in fraud in the sense that they cover up fraud cases and fail to bring them to the attention of the judicial authorities. What I want to say is that there is another common approach to insurance fraud that implies that most cases of insurance fraud are no longer "fraud" in the classic meaning of the term and, consequently, the prosecution is not treated in a judicial manner. I am not quite sure whether this approach to the phenomenon by the insurance industry is a commercial practice, represents a double moral standard, or is a truly new conception of what could be considered "crime" and what is not. Exaggerated claims are probably the best example to illustrate this situation. We can define exaggerated claims as those claims that are presented to an insurance company with exaggerated values on purpose. These exaggerations could be small amounts of money or very large ones, but in any case, these are, according to Robert Emerson, the most important ones financially for the industry.[149] Insurance companies do not call this practice fraud. Rather than bring this kind of situation to the attention of the authorities, what insurance companies do is try to settle the difference with the insured and avoid, in this way, the judicial process. By doing so, insurance companies win in two respects. First, the client is well treated and, with the quick settlement of the claim, rather than a lengthy judicial process, the client feels good and probably will continue doing business with the company. Second, the company saves money in investigations and judicial procedures while solving a case of "fraud" in a "friendly" way. In the words of Michael Clarke,

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[147] The money amounts of fraud vary from $100 to $1000 in 70% of the cases, according to the Insurance Bureau of Canada, "Facts of the General Insurance Industry in Canada" (Toronto: November, 1997) at 16.

[148] G. Bourgeault, "Assurance, fraude et societe actuelle", in Jean-Louis Fortin et Jacques D. Girard, *La fraude a l'assurance*, (Montreal : Universite de Montreal, 1992) at 67.

> ...because of the emotive nature of their business, insurance companies have a relatively strong service ethic. In the words of one company's current advertising campaign, they 'don't make a drama out of a crisis.[150]

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[149] Emerson, *supra*, note 25 at 930.

[150] Clarke, *supra* note 153 at 1.

2. Insurance companies and the scheme of the state: a preliminary discussion for a new system.

Once the insurance industry finds that the normal channels to confront the problem are insufficient (I am referring to the criminal justice system, in particular, and private law, on the other hand), it decides to deal with the problem directly.[151]

Like a small state, insurance companies have created a complete system to defend themselves and their innocent clients (the insured who are not involved in fraud) from insurance fraud. Insurance companies, at the end of the twentieth century, are very similar in their structure to the general structure of the modern state with its legislative, executive and judicial branches. The features of the modern state could be defined as follows:

> Primarily a State exists in a geographicall territory over which it holds jurisdiction. It possesses authority to carry out actions and it is the source of law; its fundamental aim is to promote the commonwealth or common good. The really crucial formal feature of the State, which has most continuity and certainty is that it is a continuous public power. Thus the State, as public power, embodies offices and roles which carry the authority of the State. [152]

For instance, insurance companies offer services that, at the end of the day, are solutions to and protection from particular situations similar to those provided by the State. With the sale of protection and the guarantee against certain risks, what insurance companies do is to solve the daily conflicts of their clients, as the state does as well. For example, when a person buys an automobile insurance policy and later has an accident, what insurance companies do is first examine the type of the accident and, according to the circumstances of the claim and the contract, give to the insured a correct solution, which can be replacing of the car, paying a sum of money or repairing the car, everything in order to return the insured person back to his or her initial situation. In this process, the insurance company is displaying power in many senses. With the subscription of the contract, the insurance company sets its conditions in a unilateral way, similar to when the state settles conditions for its citizens in many aspects of social control. Once the adhesion contract[153] is completed, the insurance company charges an economic retribution from the insurer (the premium), similar to the taxes that state charges to its citizens. Once the claim takes place, a set of actions occur in order to proceed with the compensation for the loss.

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[151] *See*, statistics, Chapter One, page 26.

[152] A. Vincent, *Theories of State* (London: Basil Blackwell, 1987).

Criminal law, as a set of rules typically promulgated by modern States, can be defined as a *"technique of definition, verification and repression of the deviation."* [154] However, this technique is not exclusive to the State and, on the contrary, can be found in parallel form in other segments of society.[155] This is precisely what occurs in relation to the treatment of fraud on behalf the insurance companies.

The similarities of the model used by the industry with the criminal justice system are incredible. In fact, the methodology is no more than the scheme proposition, investigation and sanction (the syllogism if...then...), more or less the scheme that the criminal justice system uses in the prosecution of other crimes.

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[153] The insurance contract is called an adhesion contract because most of the times the insured have to submit himself to the conditions of the insured without any possibility of negotiation around the contractual conditions. *See* Hardy, *supra* note 58 at 133.

[154] L. Ferrajoli, *Derecho y Razón* (Madrid: Alianza Editorial, 1997) at 297.

[155] The scheme definition, verification and sanction takes place in social contexts such as school, family relations, religion and politics.

2.1. Definition

In terms of the "preposition" or the definition of certain conduct, insurance companies have been including clauses in the contract in relation to fraud, misrepresentation, misdescription and non-disclosure, that allow the insurance company the possibility of warning the client of the eventuality of voiding the contract if some of these situations take place. [156]

Insurers have created their own definitions and prescriptions according to their particular perspectives on insurance fraud and their own technical and social needs.[157] Manuals providing advice on insurance fraud in companies such as Mapfre in Spain, La Previsora in Colombia, the General Manual of the British Insurance Association in England, the Red Flags for Detecting Insurance Fraud from the Canadian Coalition Against Insurance Fraud[158] in Canada and the anti-fraud insurance manuals from the anti-fraud divisions in many states of the United States reflect this situation. Hence, this is how private industry uses the "technique" of criminal law to construct a factual definition in parallel to the criminal system. Therefore, we have then the first characteristic of the *criminal law technique* which is the construction of a prohibition in relation to a certain way of acting.

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[156] One of the origins of the duty of disclose was precisely to prevent cases of fraud in the insurance contract. *See* S. Park. "Origin of the duty of disclosure in English Insurance Contracts" (1996) 25 Anglo American Law Journal at 221-235.

[157] The Canadian Bar Association in its publication *Theft, Fraud Breach of Trust and Other Crimes of Greed*, (Toronto, 1991), points out how difficult is the application of Criminal Code law in relation to fraud, since the concept of "other fraudulent means" and the term "dishonesty" are obscure and excessively abstract. This document help us to demonstrate how the insurance companies' model to fight against fraud could be legitimate in terms of efficacy and validity.

[158] This Manual is probably one of the most important ones in the worldwide industry. As it describes itself "...the "red flags" are facts or circumstances, which, if discovered in any insurance claim, require further follow-up...". Canadian Coalition Against Insurance Fraud, *Red flags for detecting insurance fraud* (Toronto: 1998).

This situation implies that insurance companies have to design and put in practice ***in-house*** administrative instruments to control and prevent the problem, all of which are characterized by a huge *descriptive power* of the problem as well as specific sanctions contemplated in or out of the contract. These prescriptions, supported by the Insurance Acts in Alberta and other Canadian provinces as well as in other laws around the world such as the civil code in Spain,[159] are in fact the ***prescription*** itself in terms used by the criminal law.

2.2. Verification

Before the payment takes place, often insurance companies undertake investigations through their own investigative departments, in the same way as the state does when it has to solve civil, criminal or other problems among citizens, (the RCMP in Canada or other investigative bodies in other countries).

Companies around the world have started to create specific in-house anti-fraud divisions in charge of fighting insurance fraud and have started to organize information sharing between companies by creating specialized research institutions.[160] Specific departments in the companies, as well as institutions created by insurance companies follow the scheme of the criminal law which does not necessarily imply the use of it.

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[159] H. McCarley, "New insurance legislation in Spain", International Insurance Law Review (1996) 4 at 27-29.

[160] According to E.L. Schrenk and J.B. Palmquist, "Fraud and its Effects on the Insurance Industry" (1997) 64 Defence Counsel Journal at 24, fraud agencies "...recent experiences suggests that industry is responding. According to a 1992 study by the Insurance Research Council, insurance companies were spending more than $200 million annually in fraud detection. By 1996, 75 percent of property casualty insurers had special investigation departaments, upfroma mere 2 percent in 1983. Many of those who did not relied in strong claims training programs and external."As a reference, the most relevant institutions are the ***Coalition Against Insurance Fraud*** [160], ***The National Insurance Crime Bureau***, ***The National Automobile Theft Bureau***[160], ***The Insurance Crime Prevention Bureau*** and the ***Insurance Committee for Arson Control***, all of them in the United States. In relation to Canada, the ***Canadian Coalition Against Insurance Fraud***[160], the

2.3. Sanction[161]

Similarly, the ***visible*** sanction is actually inside those laws where we can find, among others, the cancellation of the contract and the impossibility of recovering the money from the claim. I say "visible sanctions" due to the fact that insurance companies have developed *black lists* ("invisible consequences") among the industry that ostracise the fraudulent insured for the rest of his or her life, which is, among other things, another powerful form of sanction that is in many cases more effective and viable than prison, the "formal" sanction prescribed by the criminal justice system.

Meanwhile, principles such as those that exist in law are present, for instance, due process, the defence, the legality of evidence, etc. Finally, a specialized department in the companies called the "indemnity department" gives the order to pay the claim, or whatever solution to the claim has been selected. In this system, the hierarchical structure of the company, the power that it always displays, and its relation with its client seem to be a relation like the one between the state and its citizens. In my opinion, insurance companies are like small states inside of another state.

Continuing with the metaphor, in terms of fraud, insurance companies cannot use

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Insurance Bureau of Canada and the ***Insurance Crime Prevention Bureau*** are the three most important entities in combatting and studying the problem.

[161] The Sanction Issue will be discussed in more detail on Section 3.1. of this Chapter.

force to punish the insured, or at least they cannot display force in the same way that the state does through, for example, imprisonment. However, insurance companies have, as well, their own system of punishment. Sanctions such as ostracism, fines contemplated in the contract, the cancellation of the insurance or the denial of the claim are certainly truly steps taken against the insured. All these sanctions, well established in the contract and previously communicated to the insured at the time when he or she took out the insurance policy, seem to be the model of a social contract in which one knows the rules of the state and agrees to follow them.

2.4. Analysis.

The relationship of insurance companies to fraud was not a problem twenty years ago when the problem was not yet defined, neither by the criminal justice system nor by the insurance industry. In the 1970's, fraud was considered a problem only for the employees who had to deal with the indemnity process.[162] Because it was not defined in a proper and technical way, it was not considered a serious problem by the marketing, subscription, and claim departments of the companies. It is impossible to do an historical analysis of the behaviour since its control was in the hands of a group of people in restricted areas of the company, more precisely in the indemnity or claims department. There was not a process of knowledge accumulation, the treatment of insurance fraud and its background was not transmissible, carrying as a consequence that the notion and knowledge of the problem were isolated, and there was not a clear intention of how to combat and eradicate the issue.

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[162] Accordingly to E.L. Schrenk and J.B. Palmquist, "...historically, the insurance industry has been apathetic or naïve about the impact of fraud. The reasons? There was concern for potential tort liability arising from investigations, especially as many states did not have common law or statutory immunity provisions. Some insurers wanted to avoid publicly acknowledging fraud. Some were hopeful that fraud simply would go away. Others thought that publicising fraud or reporting it to federal authorities sent the wrong message to the public..." *supra* note 166 at 23.

During the 1980's, the situation was modified at an international level when in countries such as France and the United States, many anti-fraud institutions began to be created.[163] When insurance fraud came to be defined as a behaviour with specific characteristics and a *modus operandi* and when it was included in the technical manuals of companies, the reciprocal recognition of the procedure ("actions and actors") began. Therefore, the issue became a recognised concept, ***independent from the volition of employees*** who are in charge of the indemnity process. The reciprocal recognition of the phenomenon makes it a crucial point in the business as well as an industrial conflict, not just a sporadic legal conflict as it was formerly considered. Through the recognition and definition of the problem in the terms explained, the transmission of knowledge in relation to the problem was possible, resulting in the institutionalisation and the historic recognition of the issue. Thus, institutionalisation produces an immediate effect in relation to the control of the specific reality. The language, through its power of definition, permits the control and protection of the victim from the aggressive conduct of the perpetrator. The world of insurance fraud is then objective and perfectly recognisable. [164]

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[163] For instance, ALFA (Asociation de lutte contre la fraud a l'assurance) founded in France in1985, is the result of the establishment of a liaison group of all insurers to co-ordinates fraud control among other French institutions that have been fought against the crime since 1970's. In a like manner, the Coalition Against Insurance Fraud (Washington D.C.), founded in 1987, is an independent, non-profit organisation of consumers, government agencies, and insurers dedicated to combating all forms of insurance fraud through public information and advocacy.

[164] For instance, the British Law Commission in its consultation paper No. 155 (1999, p.5), *Legislating the Criminal Code: Fraud and Deception*, point out that: "the ambiguity of the term general fraud offence in the actual legislation is one of the most crucial parts to be reformed. Its inaccuracy

To synthesize, insurance fraud has been institutionalised and, as a consequence, it has been transformed into a form of social control. These are the elements of the process:

1. The reciprocal recognition through language.

2. The institutional integration in a collectivity.

3. The generation of historic knowledge in relation to the problem.

Through the initial description of how insurance companies deal with fraud, I have pointed out a parallel between some characteristics of the criminal justice system and schemes used by the insurance industry to control the issue. The existence of an extra-judicial recognition in the terms aforementioned, sanction mechanisms that by pass the ordinary justice system, prevention politics based on socialisation rather than resocialisation and, finally, a scheme of detection of the problem with marked characteristics of police functions, can lead us to think about a parallel system in relation to the criminal justice system since the new model considers the essential characteristics of punitive social control.

How is the recognition of the model achieved? The private sector does not ignore the existence of the criminal justice system. Rather, it has designed a more effective way to control the problem and, moreover, a less expensive method in the terms of Ferrajoli[165] (court expenses, etc). Insurance companies recognize the state power of definition, the definition of non-desired conducts, yet they expand the definition itself in order to apply it in cases of insurance fraud. Accordingly, we think that it is possible to see fraud control under the perspective of the ***primary deterrence*** theory. The fraud control model used by insurance

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conduce the bench and the bar to incorrect appreciations of specific kinds of fraud expressions".

[165] Ferrajoli, *supra* note 156, at 345.

companies is not an illegal model, and it is not indeed a private justice system based on revenge. It is simply a parallel model that respects essential guaranties of the social contract. It is, in this sense, that the ***general deterrence*** theory, the preventive influence of legal sanctions on those who have not been previously sanctioned,[166] can be applied since the model can recognize judicial expectation, in other words, the respect of the right of property coined in social relations.[167] Insurance companies, acting against an illegitimate event, recognize, first of all, the essential nature of the deviation, defined in the criminal legislation, and second, the existence of property rights. The purpose of the action taken by insurance companies against the defrauder is to seek compensation as well as to protect a normative expectation. This respect for the expectation is what permits this form of the social control to be bound to constitutional principles. This is where a new intent for a recognition of the model begins.

Hence, the idea of conceiving insurance companies as small states within a state is more a factual reality than a theoretical conceptualization.[168]

For many authors, this situation is termed the ***privatization of functions***.[169] The questions are then, Can justice really be privatized? Is not the exercise of power a monopoly of the state according to political theory? Certainly it is, and we have to preserve this principle. However, what is the real essence of this postulate? Does it cover private activities when they do not involve a substantial public risk, a substantial public issue?[170]

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[166] Cramer, *ibid.* at 16.

[167] Cohen, *supra* note 13 at 214, 232, 263.

[168] This thought has to be developed deeply, and for the purposes of this thesis it constitutes a reflection more than a completed idea.

[169] J. Hampton, "Does Rawls have a social contract theory?" in Henry S. Richardson, *Philosophy of Rawls* (New york: Garland Publishing, Inc. 1999) at 109

Certainly, the reality of what is called the ***"privatization of public functions"*** is not new. In other aspects of citizen's life, institutions exist that are in control of moral and apparently "public" issues. For example, in family relations, the consumption of alcohol, and some aspects of social life in schools, universities and even work places, institutions are in charge of the regulation, control and punishment of many aspects involved in these relations. Is insurance fraud an issue that affects public morality, public stability and public security? The reality of the problem, seen throughout the treatment that it is given by society, provides us a first answer: insurance fraud is a private issue that has to be treated using private initiatives (the case of England, as we already mentioned, confirms this situation).[171]

Finally, the works of Jean Luc-Bacher and his group at the Centre of Criminologie at the Universite de Montreal have analysed Canada and Switzerland, countries where the state does not participate in the regulation of insurance companies, and thus they can freely organize their fraud prevention policies, obtaining good results without activating the penal system.[172]

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[170] The most common worry around the issue of "private justice" or the "privatization of the public function of justice" is the legality principle, however, the principle can be saved in hands of the industry throughout public and private instances of control such as, in Canada, the Canadian Insurance Bureau and the Canadian Coalition Against Insurance Fraud. *See* Chapter Five.

[171] Wagstaff, *supra* note 27, at 12.

[172] F.Ocqueatau, Prevention et assurance: le role des assurances dans le pilotage de la securite privee, at Deviance et Societe, X, 1, 1986. "La Fraude a L'assurance, actes du colloque organise par le bureaud d'assurance du Canada et la Fondation Conrd-LeClanc en collaboration avec L'Universite de Montreal", Sous la direction de Jean-Louis Fortin, Jacques D. Girard et Jean Luc-Bacher

3. The Response. Tactics and Techniques. Where is the fight really situated?

Evidence and effectiveness in private management.

The insurance industry as a whole has developed in many countries expert systems to fight against insurance fraud. The creation of centralized computer systems to which the insurance companies report the characteristics of claims and the insured in order to make correlations between claims in other companies is one example of how the industry is taking control of the problem.[173] Associations, leagues and other institutions created by insurers to control the problem, most of which are private, are also good examples of how the industry is organizing itself around the issue.

However, we cannot consider the private treatment of fraud by the private companies as a real emulation of the criminal law because it does not yet meet the second condition of the *technique*, the possibility of investigating a fraudulent event, a task under the authority of the police in the criminal justice system. In order to solve this problem, insurance companies have designed mechanisms of information analysis that provide the possibility of detecting cases of fraud, mechanisms that, along with private investigation, prove that fraud has occurred.[174] This cognitive formulation appears when we have a formal definition of the fact from the insurance companies and a factual verification of the event in reality,[175] a typical criminal formulation.

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[173] M. Clarke, "Insurance Fraud"(1989) 29 The British Journal of Criminology.12

[174] What we have here is the submission of the theory of the criminal process applied to a cognitive formulation between a definition and a typical fact of the reality; Ferrajoli, *supra* note 161.

[175] Verification of this reality has produced not just general definitions of what is insurance fraud, but also specific types of the deviance. As an illustration, the Special Investigative Unit of the Canadian Coalition Against Insurance Fraud has produced the following categories: insuring phantom property, misrepresention of how insured property is used, inflation of the losses of claim, claiming for false no-fault accident benefits (salary replacement benefits), arson commission, staging a

In relation to private investigators, they perform the function that in a state is the mission of the judicial police, for instance, the FBI in the United States or the RCMP in Canada. Indeed, they compile all necessary evidence in order to reject the claim and to prepare the company, in rare cases, for a possible criminal trial.

3.1. The Sanction Issue.

One of the most problematic and complex elements in the insurance business in relation to fraud is the sanction issue. The only formal alternative that companies have at this point is either the criminal process or the compensation for the loss (caused by unfair payment of a claim) through a civil action. However, in countries like Colombia and many others with fragile judicial systems, the application of judicial sanctions frequently target the most economically powerful, a situation that often leads the industry to ignore the judicial option. For instance, just 2% of fraudulent cases are prosecuted in Colombia,[176] and my suspicion is that the situation is not better in Canada.[177] This situation leads to a construction of private systems of sanction in insurance companies that makes unnecessary the use of the criminal justice system.

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burglary, reporting phony auto thefts, inflation of the costs of a claim to cover previous damage to an automobile, staging an automobile accident to obtain payments under the owner's or third party policy, inflation of the repair costs an offers of kickbacks to policyholders, among others.

[176] Fasecolda, *supra* note 7 at 12.

[177] In Florida, the Florida Institute Research Centre have founded that the denounce insurance fraud is rarely and one of the reasons is precisely the knowledge of the company of its weakness in Court as well as the judgment proof status. *See supra* note 25 at 947- 949.

The principle sanction tool outside of the criminal justice system is, then, the denial of the claim.[178] The company, after evaluating a case and reaching the conclusion that fraud has occurred, denies the payment to the defrauder, a decision which implies two possibilities. The first is that the insured sues the insurer in order to establish, by a judicial decision, the reality of the facts or, second, the insured passively accepts the economic sanction imposed by the company.[179] In fact, when a defrauder is discovered committing the illegal conduct, he/she prefers the economic sanction imposed by the insurance company rather than the criminal process, which is more onerous in terms of punishment. The general rule is then that the insured accepts the sanction from the insurer and, in case of a legal action from the insured, as a consequence of the sanction imposed, the company generally opts for an economic negotiation because the lack of evidence can put it in an unfavourable position in the trial. In the United States many states such as New Jersey have created, by enacted legislation, fees to be charged to the insurance companies' employees if they permit the commission of fraud, fees payable to the insurer in the case of actual or attempted fraud.

The sanction used by insurance companies is the denial of an economic benefit. This implies that the defrauder loses his rights from the policy, the compensation from the loss. As a consequence, the defrauder cannot claim either the indemnity or the payments that he or she has made in premiums. The loss of rights is what characterizes the punishment in criminal law. For instance, imprisonment is in fact the loss of the right to liberty, and the fine is the loss of a private property right. Therefore, the punishment that companies impose is the loss of the right to receive economic compensation derived from a calamity. In this way, the third condition of the definition of criminal law that we are using in this chapter, the sanction in the form of losing a right, is finally achieved. In other words, through this new *technique*, the individual who has broken the law has been effectively punished.

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[178] In the province of Alberta see Insurance Act (R.S.A c. I-5.1) s.s. 613(1) and 549(2).

[179] Since Edwin Sutherland published his book *White Collar Crime*, it has believed by many scholars that economic sanctions are more useful to combat white-collar crime than prison.

The sanction used by the insurance company is a retribution for the behaviour of the defrauder when he/she loses the right of indemnity, implying for the company a real retribution.[180] Hence, we can say that the punishment imposed by the insurer ratifies the existence of general norms of law and abundantly satisfies what has been constituted as the nominal subject of the action. The theory of punishment is changing in the sense that the sanction is not a "traditional" penalty, not a mere formal guarantee or expiation form, but a real way to solve conflicts.

The model does not support, from any point of view, an analysis under the ***primary deterrence*** theory, a theory that refers to the preventive influence on persons on whom particular sanctions have been placed.[181] Furthermore, punishment imposed by the companies according to the principles aforementioned does not look for rehabilitation of the individual. The defrauder is simply considered an infractor, not a pathologic being who has to be reeducated for the good of the social order. The individual who is sanctioned is not "redeemed;" he/she does not atone for a crime. He/she simply receives a sanction that is

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[180] C. Roxin, *Politica Criminal y Sistema del Derecho Penal (Criminal Politics and Criminal Justice System)* (Barcelona: Editorial Casa Bosch, 1972) at 14.

[181] J.A. Cramer, *Preventing Crime* (London: Sage Publications, 1978) at 15.

independent of his condition as an individual. The subjective element is then excluded, and the transition to an objective consideration is finally achieved. In a hypothetical case, if somebody has failed in his duties to the social order and has then to compensate the society, he/she does not have to be punished to be reeducated. This new approach allows the understanding of the offence as a problem isolated from the individual and not as an inherent characteristic. The consideration of the conduct refers to the nature of the offence itself.

3.2. The prevention mechanisms.

Prevention mechanisms designed by insurance companies depend on the vigilance of the business for the detection of apparent or actual cases of fraud. The first of these mechanisms consists in the control of variables of the business, such as the date of subscription and the occurrence of loss among others, that permit the detection of possible cases of fraud through the use of *risk indicators*. With this kind of system, a company can classify claims into the categories of "good" and "bad" ones, providing a first classification for a further deeper exploration. This system is integrated into the organizational structure of the company considering the positions and responsibilities of each employee. Hence, each employee has the responsibility to periodically report to his or her superior a certain number of fraud indicators derived from his/her specific responsibilities. Thus, the president of the company can control his/her vice-presidents; likewise, they can control their managers, the managers their employees, etc., in a chain of control based on risk indicators that involve the whole company in many facets of the insurance process.

As well, contests among employees are a crucial second strategy to obtain information about suspicious cases of fraud. Through these corporate events, companies look for "informal information" that is not available in files, in the fraud indicators previously mentioned, yet that may be observed in the contact of the employee with the client and with the insurance agent. Accordingly, we have a *quasi* perfect "police control" with information provided through a hierarchical system of information as well as through informal body of another kind of information that helps the company to effectively detect fraud cases.

The in-house training of employees in anti-fraud detection techniques is one of the best tools to combat and prevent the problem. Nowadays, employees are trained to confront fraud using technical instruments such as the fraud indicators mentioned before as well as guidelines of behaviour and business ethics. At this point, employees have to study various manuals that contain the correct steps to follow in fraud cases, or suspicion of them, during the whole insurance process (underwriting of the policy, its modification and the claim). When the risk of fraud is inherent in a special kind of insurance, for instance certain kind of insurance policies for automobiles, insurance companies usually take the decision to cancel the product.

If we analyze international experiences related to the fight against insurance fraud, we will find that almost every developed western country has its own institutions in charge of studying and fighting against this problem.[182] In the United States of America, probably the country that has been most dedicated to the study, we can find, in almost all states, private and public institutions dedicated to the study of the problem and developing projects of many types. Even more interesting is that they cover two realms in their research, the legal and the business ones. In other words, they are looking at issues related to the laws of the crime of insurance fraud as well as matters related to the development of the insurance industry business. The United States of America, as well as Canada, have the most influential experience in the world in dealing with the fraud problem. With many institutions in charge of investigating, as well as practical developments to fight the problem, these countries are worldwide leaders in matters related to insurance fraud. The most relevant institutions are the ***Coalition Against Insurance Fraud,***[183] ***The National Insurance Crime Bureau***, ***The National Automobile Theft Bureau,***[184] ***The Insurance Crime Prevention Bureau*** and the ***Insurance Committee for Arson Control***, all of which are in the United States. In Canada, the ***Canadian Coalition Against Insurance Fraud,***[185] the ***Insurance Bureau of Canada*** and the ***Insurance Crime Prevention Bureau*** are the three most important entities in combatting and studying the problem. [186]

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[182] Professor Michael Clarke from the University of Michigan has been studying the development of the response to insurance fraud in many countries in Europe. Clarke, *supra* note 153 at.1-23.

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[183] Founded in 1987, the Coalition is an independent, non-profit organization of consumers, government agencies, and insurers dedicated to combating all forms of insurance fraud through public information and advocacy.

[184] Founded in 1912 in Palo Alto, Illinois, it is the oldest institution in terms of insurance crime prevention. In terms of insurance fraud, the organization works in the prevention of false claims related to automobile theft.

[185] The *Canadian Coalition Against Insurance Fraud* was founded in June, 1994 to implement a series of actions to curb property and casualty insurance fraud. Coalition members represent the full spectrum of stakeholders concerned about the cost of insurance fraud, including the private insurance industry, police and fire services, consumer advocacy groups and public auto insurers. Insurance regulators participate as observers of the Coalition's activities. The Coalition's activities are aimed to reduce the cost of insurance fraud through increasing public awareness, changing business practices, improving investigative and enforcement techniques, and changing the legal and regulatory environment.

[186] Although the specialized institutions in Canada and the United States came from the middle of the 80's, it is believed that the phenomena has been seriously studied by the insurance companies since the big depression in 1929, when the people found in insurance policies a great possibility to get easy

In Europe, France has relevant experience in combatting insurance fraud, probably the most important nowadays, and undoubtedly is the leader in Europe. Institutions such as ALFA[187] (***Association Contre la Fraude a L'assurance***) have been working in the field for more than twenty years. Its involvement with the police authorities is a remarkable characteristic, and their achievements are recognized and followed by other institutions of the same or similar type in Europe.

Holland is another excellent example of how the insurance industry is working against insurance fraud. The ***CIS System***[188] is a centralized computer-based control system that contains information on all the insured in Holland, including all the claims reports involved in all kinds of insurance. The system makes correlations between them and establishes suspicious claims for further investigation. In this matter, Holland is working apart from the police, designing a particular and independent method to monitor fraud.

Great Britain, through the ***British Insurance Association,*** has been working in fraud prevention trying to reinforce the importance of denouncing fraudulent claims among the insured. Along with the ***Crime and Fraud Prevention Bureau,***[189] the Association offers support to the British insurance companies in areas such as training in detecting fraud as well

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money.

[187] Founded in 1985, ALFA is the result of the establishing of a liaison group of all insurers to co-ordinate fraud control among other French institutions that have fought against the crime since 1970's.

[188] Founded in 1987, the system is paid for by insurers through a percentage levy on their premium income.

[189] Founded in 1989, the office directed by Mr. John Wagstaff has done more than 5 educational videos for the insurance companies and published a monthly report of the most important frauds committed.

as funding public campaigns.[190]

4. Conclusions.

As a preliminary conclusion we can say that:

1. The treatment of fraud by insurance companies is a form of social control in parallel to the criminal justice system and has a significant relation to the technique of criminal law.

2. The "new technique", or the new use of the technique, has to be bound to the principles of the guarantee theory in order to stop the abuses that it can cause.

3. The model tries to solve a conflict and, at the same time, pretends to ratify the basis of a social act of living together. It tries to transform the criminal law into a social alternative of solving conflicts rather than just act as a justification technique of the State.

4. The punishment used by the new model solves the conflict and satisfies the parties, which is better than the punishment of the criminal law that isolates the wrongdoer from the solution of the conflict, submitting the parties to a different process to satisfy their particular interests.

I have tried to demonstrate how in the treatment of fraud by insurance companies we find characteristics of the formal model of criminal law that permit, from the point of view of punishment theory, but not from the state theory, the justification for this model.

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[190] Other institutions are: In Italy, ANIA (***associazione nationale di la industria aseguratora***), in Rome, their work in insurance fraud has been developed with the collaboration of the ***British Insurance Association***. In Spain, the ***Unión de Asegurodores Españoles - UNESPA*** (Insurance Companies Union), have been working with certain insurance companies such as ***MAPFRE,*** trying to develop insurance fraud manuals as a technical support to the rest of the industry. The Spanish experience is more related to particular programs into the insurance companies. Athena Insurance Company is a great example. This company has been saving US$ 3 million per year through contests among employees and insured.

It is perfectly possible that from this particular approach to the reality of the problem, the conduct that the criminal justice system calls ***"fraud"*** is no different than any other ***"risk"*** in the business and a situation that has to be solved between the parties of the contract, the insurance company and the insured, excluding the judicial system.

From this new perspective, insurance fraud is an important concept in the mind of the modern legislator, but not in that of insurers. It is generally accepted that the processes of criminalization, as we analysed, are sometimes against the factual reality and according to the thought of the legislator without considering the other side of the coin.[191]

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[191] Szabo Denis, *Conducting Evaluative Research and Implementing its Results Dilemmas for Both Administrators and Researchers*, (Montreal: International Centre for Comparative Criminology - Universite de Montreal, 1977) at 11.

Chapter Six

Having described the problem in Chapter One and provided a general idea of what insurance fraud is from the descriptive point of view, as well as having described the different approaches from three sets of legislation, the Canadian, the English and the American, and the responses from the insurance industry itself, my purpose in the following chapter is to introduce the reader into certain topics that help us to understand the main proposal of this thesis in relation to the decriminalization of insurance fraud, and the failure of the Criminal Justice System in dealing with the problem. In other words, I intend to explain how the criminal law failed, and how the example of insurance fraud in a certain way leads us to a new model of understanding crime.

The analysis of the problem through the lenses of sociology and criminology opens a new model for understanding insurance fraud, yet the most important contribution is the proposal of a new model of treatment. From the legal perspective, we have described the failure of the system in the control of the problem. From sociology and criminology, I will develop arguments that point out the possibility of other instances of control of social deviance, not necessarily involving the criminal justice system.

I will examine, (1) the failure of the Criminal Justice System by analysing its limits and purposes,(2) the behaviour out of the criminal justice system, (3) the possibility of thinking deviance without law , (4) a proposal for a new conflict resolution scheme, (5) the theories of abolitionism and radical non-intervention as a theoretical support for the subtraction of insurance fraud from the criminal justice system

1. Where the problem rests.

None of the systems aforementioned, the English, the Canadian, or the American, is better than another. What is really happening in the fight against insurance fraud on a worldwide level is that no matter what law exists, the problem is growing. As well, more important, for insurance fraud, as for no other monetary crime, governmental and non-governmental institutions have been created charged with studying the problem and creating solutions in addition to judicial procedures.

The first set of legislation, the English and Canadian, demonstrates less judicial intervention in the problem as, for example in England, where the substantive offence is not considered as a crime and, in the case of Canada, where the offence exists only in its general description, but not for insurance fraud in particular. Therefore, the attitude of the legislator in these latter cases demonstrates, intentionally or not, less intervention in the activities of individuals, and on the other hand, a general description of a conduct that has to be fit by prosecutors and judges into the specific category of insurance fraud. In the United States, the description of the conduct of insurance fraud in both the criminal and the civil field, with a vast quality of details, could demonstrate on the one hand, the importance that the government has attached to the problem and, on the other hand, the degree of intervention of the State in the particular relations, a politics of criminality that corresponds to a liberal model of the State. However, none of the legal solutions is really working if we measure the effectiveness of the law in terms of the number of crimes committed and the rate of growth.[192]

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[192] *See* Statistics, Chapter One, page 26.

In contrast, what is really working, appears to be the intervention of private industry in the solution of the problem. Insurers know the inconvenience produced by the legal treatment of insurance fraud and, even though they do not admit this position officially or publicly, they are not especially interested in persuading the police, in particular, to take an active interest.

As Michael Clarke says:

> Insurance is regarded as a private contract between insurers and insured; even if criminal fraud is committed, the tendency of insurers is to deal with the matters themselves unless there is a clear evidence of prosecution, in which case it is passed to the police with the expectation of effective action . . . More fundamentally, however, claims are regarded by insurers as matters to be settled between them and the insured privately.[193]

In countries with less developed justice systems and where the credibility of the legal system is very poor, insurance companies prefer to deal with the problem directly before becoming involved in a never ending judicial process. In countries such as Canada, with an effective justice system, many insurance companies still not use it, not for the reason explained for countries such as Colombia, but because of commercial reasons that force them to manage the problem in a prudent way.[194]

The criminal law in its treatment of insurance fraud examined from the theoretical point of view seems to be quite adequate. With different approaches to the problem that seem to be the result of differences in the politics of criminality, both the American and the Canadian system have tools to fight against the problem through the criminal system. The problems in the judicial option rest more in procedural difficulties than in substantive problems, for instance, in the difficulties that prosecutors face obtaining evidence to sustain a case of insurance fraud. In any case, this is not a problem exclusive to the offence of insurance fraud but is, on the contrary, a problem that almost the entire criminal system shares. Therefore, the fact that some countries set out specific and concrete offences to fight against insurance fraud (United States), while others do not (Canada and England) is just a rhetorical difference. In all cases, insurance fraud is a problem that cannot be solved using legal tools. The conceptualisation of the reality through legal language is not the problem. On the contrary, in addition to the problem that exists in the real world, the legal approach invents another problem: how to treat a non-legal problem with legal instruments.[195] Insurance fraud is a problem. It is in fact an undesired behaviour, a cancer of the twentieth century,[196] but its remedy, to a considerable degree, does not rest in the criminal justice system.

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[193] Clarke, *supra* note 153 at 16.

[194] Bacher, *supra* note 91 at 324.

2.The failure of the Criminal Justice System in dealing with insurance fraud.

2.1. The limits and purpose of criminal law.

> What we can call good must be, in the judgement of every reasonable man, an object of the faculty of desire, and the evil must be, in everyone's eyes, an object of aversion. So it is with truthfulness as opposed to a lie, with justice in contrast to violence, etc. But we can call something an ill, however, which everyone at the same time must acknowledge as good, either directly or

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[195] I am referring to the problem of insurance fraud itself, and not to topics such as the insurance contract and other civil and criminal issues related to it.

[196] J. Bovay, *Quelles mesures efficaces mettre en place en amont de la fraude pour mieuxla prévenir*, Conférence IIR, -, Vaudoise Assurances, (Paris 20 et 21 novembre 1996), at 6.

indirectly.

Immanuel Kant[197]

Where can we localize the limits between what is the business of the civil law and the criminal law? Is there any possible criterion different from the volition of the legislator in saying what deserves to be punished by criminal law and what by the less intrusive civil law? Is it true that one of the measures to determine this issue is related to the degree that the act is affecting society in general or is it rather just a private situation in which the public morality is involved? Is it then related to the quality of the damage, the number of persons involved, and the values that exist in society at a certain period of time?

Indeed, what is in the Criminal Code and what is not corresponds to great degree, even in most civilized cultures, to a process in which the current moral standards, the interests and values of the legislators, politicians and other interest groups, and the trends and fads of the time largely intervene. According to the Law Reform Commission of Canada (the "LRCC"), the role of criminal law is to protect the core values of a society, "thereby fostering and strengthening the shared trust necessary for the survival of a social system."[198] From this affirmation, we can see how criminal law is a matter of values and principles, some of them that have been among us since early times, such as those dealing with murder and rape, whereas other concepts such as fraud and cyber-crimes, for instance, correspond to a more modern time. In any case, values and principles are derived through " the art of distinguishing what is bad and what is good," and constitute the basis of what is or is not considered crime:

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[197] I. Kant, *Critique of Practical Reason* (New York: Liberal Art Press, 1956) at 56.

[198] Law Reform Commission of Canada, *The Limits of Criminal Law -- Obscenity a Test Case.* (Working Paper No.10) (Ottawa: Supply and Services Canada, 1975).

> In truth, the criminal law is fundamentally a moral system. It may be crude, it may have faults, it may be rough and ready, but basically it is a system of applied morality and justice. It serves to underline those values necessary, or else important to society. When acts occur that transgress essential values, like the sanctity of life, society must speak out and affirm those values. This is the true role of criminal law.[199]

The LRCC, as Hastings and Saunders state, attempts to clarify this approach by proposing a "test of criminality" to determine whether any act should be a crime. According to this test, one must ask:

> 1) Whether it seriously harms other people;
> 2) Whether it so seriously contravenes social values as to be harmful to society;
> 3) Whether the necessary enforcement measures will not themselves contravene social values; and
> 4) Whether the criminal law can make a contribution to dealing with the problem.[200]

However, as Hastings and Saunders explain, there are no real criteria in this test of criminality; no practical set of criteria for objectively distinguishing criminal from non-criminal behaviour has been offered. The points raised by the LRCC are much too broad. But indeed, every single criterion that includes elements of values, principles, morality, and ethics is going to be broad and imprecise, and inclined to have as many interpretations, points of view, applications and modifications as there are individuals in society. I do not consider the problem solved either by the Criminal Test developed by the LRCC or any other approach to the point. Criminal law is a field in which the criteria to add and remove rules from it depend entirely on the following aspects:

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[199] Law Reform Commission of Canada, *Our Criminal Law* (Report No.3) (Ottawa: Supply and Services Canada, 1976) at 24.

[200] R. Hastings and R.P. Saunders, "Social Control, State Autonomy and Legal Reform: The Law Reform Commission in Canada", in R.S. Ratner and J.L. McMullan, *State Control – Criminal Justice Politics in Canada* (Vancouver: University of British Columbia Press, 1987) at 126.

-The ideology of the government that is governing the country.
-Recognized social values.
-Desire of the legislator to give to certain social values the force of law.

The process of criminalization can barely be fitted in terms of "tests" and "procedures." It certainly responds more to an amalgam of subjective elements present in the legislative process.

Why is insurance fraud a crime while other types of conduct are not? What is the difference between insurance fraud and other human behaviours that are not prosecuted? The question has received many answers through the history of penal law, ranging from the necessity of controlling specific interests of the State in terms of politics, religion, or the economy, to the view that criminal law is the law of the rich that seems to project their guilty feelings onto the poor people. As Hullsman notes,

> If we compare criminal events with other events, there is – on the level of those directly involved – nothing intrinsic which distinguishes those "criminal events" from other difficulties or unpleasant situations. Nor, as a rule, are they singled out by those directly involved to be dealt with any way which differs radically from the way other events are dealt with. It is therefore not surprising that a considerable proportion of the events which would be defined as "serious crimes" within the context of the criminal justice system remain completely outside that system. They are settled within the social context in which they take place (the family, the trade union, the associations, the neighbourhood) in a similar way as "noncriminal" conflicts are settled. All this means that there is no *ontological* reality of crime.[201]

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[201] L.Hulsman, "The Abolitionist Case: Alternative Criminal Policies" (Summer - Autum 1991) 25 Israel Law Review 3 at 4.

No matter what perspective we adopt to justify punishment and to validate the criminal justice system, for instance, Durkheim's[202] view of the criminal law as a basis for social solidarity, or Marx's conception of the criminal justice system as an ideology and form of class control,[203] or even punishment as a technology of power as Foucault argues – ***criminal law as a social institution lacks rules in its construction and development. It is indeed a rule creator, but it lacks in its essence rules to determine what it should be.***

Crime is evil, yet in many respects it is important for society. It is first of all a legitimate expression of culture, which reflects in many ways the anxiety, discomfort, and problems of communities. It is definitely the best test of whether a society is happy or not, in the sense that Bertrand Russell gave to the word happiness: peace, tranquility and work. Crime has been a necessary part of society in terms, among others, of political organization, social development, and new technology. For instance, as a consequence of crimes related to drugs and alcohol, as well as those related to telemarketing and banking fraud, new technologies in relation to the prevention and detection of crimes have been developed, and social controls have been refined in order to better organize communities, police forces and other resources. However, and above all, crime is just an invention of persons (in power). It is only what certain people at certain moments in the history of a country or a civilization want to call "crime." Crime is a reflection of a certain period of history based on a complex mix of religion, economics, and beliefs of all sorts. How we can explain, for instance, that for more than three centuries justice was represented from Mexico to Peru by a couple of priests in a big room deciding whether a person was a witch or not? The Holy Inquisition was the justice of the time, and "crimes" were what the Holy Catholic Church wanted to determine as "crimes." This scheme of thinking is the same in our society, sometimes refined in many aspects, sometimes worse than the Holy Inquisition itself.

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[202] E. Durkheim, *The Division of Labour in Society* (New York, 1933) at 64. Durkheim argues that penal sanctions, characteristic of "repressive law", are a manifestation of a strong conscience collective and mechanical solidarity. The non-penal sanctions of "restitutive law" are, on the other hand, indicative of the organic solidarity associated with a developed division of labour.

[203] D. Melossi, "The Penal Question in Capital" (1976) Crime and Social Justice at 36.

Today, practically anything can be defined as a crime. The Criminal Code consists of hundreds of acts which Parliament has decided to prohibit, for one reason or another. Every year it adds more and eliminates almost none. It is debatable indeed whether some of these things need to be forbidden at all. But that is another argument. However, paraphrasing David Tench,[204] is it really necessary to make a crime of something that has to be prohibited or controlled, saying it is a crime if you do not comply? What else can be done?

The treatment given to crime and the criminal deserves the severest possible criticism. Once we boiled people, burned them to death and used the pillory.[205] Then came the use of private torture and public executions and finally the use of prison as the expression of a "civilized" punishment that is in crisis as well. Yet not just the treatment given to the criminal has been terrible, but also and perhaps equally incomprehensibly, the idea of the victim is a new concept in criminal law.

The moral ambiguity of punishment is an issue that have been in the minds of criminal researchers and criminologists for a long time.[206] The invariable conclusion of the majority of the scholars is that punishment is morally ambiguous: "we cannot be sure that it does more good than it does harm."[207] The clash of values in the criminal process, the way it works and the impact it has on society make the process an extraordinarily difficult and costly method of social control.

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[204] D. Tench, *Towards a Middle System of Law*, (London: Consumers' Association, 1981) at 3.

[205] W.E. Pettifer, *Punishment of Fomer Days*, (London: EP Publishing Limited, 1974) at 13.

[206] In terms of Packer, this moral ambiguity refers to the fact that "we cannot be sure that the punishment does more good than it does harm. See *supra* note 3 at 249.

The formal stated response to a conduct such as insurance fraud is carried out by the criminal justice system, and the penalty contemplated is prison. The criminal justice system, as explained later in this Chapter, analysing the postulates of Hullsman and other criminologists, displaces the wrongdoer from the solution to the problem and gives him a penalty that has more negative than positive results. This process has been based on what Barry Stuart has called the five myths of the criminal justice system. These are, in Stuart's words,

> (1) all criminals are the same and demand the same treatment;
> (2) only punitive sanctions work;
> (3) the public demands harsh punishment;
> (4) only professionals can deal with crime; and
> (5) there is nothing citizens can do. [208]

As a result, insurance fraud has been treated by the State using the criminal apparatus with disastrous results in terms of the growth of the problem.

As Packer says, minor traffic offences, building code infractions, violations of food and drug laws, building code infractions, and the like are best dealt with through the agency of the civil rather than the criminal law. And at the same time, a wonderful thesis is also presented in the work of Packer, what he calls "the alternative of doing nothing," the same idea that the *abolitionism* and *minimalism* schools of thought have maintained in Europe. After a careful appraisal of the costs and benefits of using criminal law (see statistics on Chapter One), we may conclude that it is better not to impose any formal sanction than to resort to one of those available in the criminal justice system. There are many aspects of the daily life of an individual in which conflicts are present, and the State does not intervene either by using the criminal apparatus or any of its other regulatory systems. "Doing nothing" as Packer says, is not itself an all-or-nothing proposition. One can decide that an entire social problem is too vast to be attacked through the use of criminal sanction and that only selected aspects should be so attacked. In relation to insurance fraud, one can propose that only certain types of insurance fraud, such as those committed by professional organizations, where more than one person participates, or those which involve crimes like homicide or other major crimes, must be prosecuted. In short, the alternative of doing nothing always includes the alternative of doing less and putting the problem in the hands of other means of social control, such as, in the case of insurance fraud, the insurance industry.

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[207] *Ibid.* at 250.

[208] S. Barry, *Building Community Partnerships: Community Peacemaking Circles*, lest Edition (Ottawa: Department of Justice, 1997) at 114.

2.2.The behaviour out of the criminal justice system.

The proposal to take insurance fraud out of the criminal justice system is more than a theoretical issue; it is an observation based on reality. Even though the criminal justice system is considering insurance fraud as a crime and its punishment imprisonment, the system is not working at all and it is not the proper apparatus to deal with this problem.

In conclusion, insurance fraud as an undesired behaviour that has been embedded in insurance practices since its origins requires a new understanding and treatment in order to be controlled. However, this conclusion leaves us with a serious dilemma, since a new conception of the problem requires a rethinking of the actual criminal justice system – the basis of the real power in the structure of the modern state. Abolitionist thoughts such as those of Bernardt de Celis, Louk Hullsman, Edwin Schur and Rudy Haapanen, among others, as well as the decriminalization approach, both propose a new view of the problem. Both are to a certain degree "naive" dreams that crash abruptly with the majority of thinkers in relation to the criminal phenomenon and the ways that have been used to control it. But no matter how radical this approach is, we really believe that abolition and decriminalization are ideas that are going to play a fundamental role in new forms of future social controls, the future of the criminal justice system. We truly believe in a new model in which the intrusive power of the state will be replaced by the private sector, while the participation of the state will be only allowed for those cases in which civil and fundamental rights are in jeopardy.

Some new trends in our society are showing that for certain kinds of matters the rule of law is in crisis.

The lack of effectiveness of the rule of criminal law in relation to crimes such as insurance fraud and drugs is astonishing. We can actually find a considerable number of publications in relation to the crisis of law and specifically to criminal law in specific areas such as those mentioned.[209] All of them try to find causes of the problem and solutions for the same. Judges, professors, independent researchers, lawyers, profit and nonprofit international institutions and the media are all thinking about the issue. The majority of authors try to find answers within the framework of the problem itself; in other words, within the framework of the rule of law. Few of them are trying to search outside of this universe. In this sense, we find some schools of thought, most of them in Europe, that are working on the possibility of eradicating the criminal law or minimizing it to its lower expression in order to find a solution to the problem. Among them are the *abolitionist*, the *minimalist*, the *criminal alternatively* and the *guarantee schools*, trends that find their roots in Sociology. In a nutshell, they recognize the actual crisis of the criminal law and propose, respectively, the abolition of the criminal law and the entrance of new methods of social control according to theories of criminal guarantees,[210] the minimalization of the criminal law and the maintenance of it only in extreme cases,[211] as well as searching for new alternatives of punishing, either in the criminal system or out of it.

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[209] M. McConville and L. Bridges, *Criminal Justice in Crisis*, (Great Britain: Edward Elgar Publishing Co., 1994); H.W. Arthurs, *Without the Law* (Toronto: University of Toronto Press, 1985); E.M. Schur, *Radical Non-intervention* (New Jersey: Prentice Hall Inc., 1973); D. Cayley, *The Expanding Prison* (Toronto: Anansi, 1998); D. Dyzenhaus, ed., *Recrafting the Rule of Law*, (Oxford: Hart Publishing, 1999).

The interest and work of insurance companies in relation to the topic, their independent achievements in the fight against fraud are, without a doubt, concrete examples of how the private industry can deal with this crime better than governmental institutions in charge of delinquency.

Insurance fraud is a private situation in which the insured has cheated and the insurance company has been betrayed. However, no one other than the companies and the community of insurers and insured have been affected by this action, and there is no real reason for the State to intervene with its criminal apparatus on behalf of society in order to impart justice. As Cayley says, "The offence is considered to have been against the society, or against the law, concepts that are likely to mean little to offenders who are estranged from society and disaffected with conventional authorities."[212]

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[210] With respect to the abolitionists we can find interesting works written by Louk Hulsman , Rosa del Olmo and Thomas Mathiesen. Luigi Ferrajoli, with his book *Dirito e Razone* (Law and Ratio) is probably the most important contemporary author in these matters; *supra* note 161.

[211] In the article "Abolitionism ou mutations du droit penal" (1985) 26, University of Ottawa, Revue General de Droit, at15 –156, L. Hullsman, professor emeritus of the University of Rotterdam in Holland, gives us a simple and short explanation of abolitionism. This text is the transcription of his interventions in the colloquy ***Etat, Accusés et Victimes***, in Ottawa 1994.

The commission of insurance fraud, when it is committed by a sole individual against an insurance company, is indeed a private behaviour that interests only the parties involved in the conflict.[213] It is difficult and exaggerated belief that the breach by fraud of an insurance contract between, for instance, John Smith and Edmonton Insurance Company, is properly a concern to the rest of the community in Canada. The idea of generalizing the consequences of a conduct certainly makes sense in cases such as State terrorism, or crimes against the public health, both of which really affect society in general. The rest of the story is an historical abuse by the State in its hurry to invade private spaces. On their behalf, particulars are used to this practice, and their culture as individuals and corporations has been developed upon the principle of minimal intervention in their own problems, as well as upon the relaying of them to the powerful and protective State. Almost no one nowadays even imagines solving a problem on their own through dialogue and direct negotiation, turning American society into the most judicialized nation in the world, a phenomenon that is spreading throughout all nations in Central and South America.

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[212] D. Cayley, *The Expanding Prison*, (Toronto: Anansi, 1998) at 49.

[213] England reflects this point in its legislation when fraud is not contemplated crime, unless it is committed in concealment. *See* Chapter Four.

2.2.1. Thinking without law[214]

The idea of governing a society without the unnecessary intrusions of law is more of a contemporary necessity than a dream or a matter of philosophical discussion. The over-regulated world in which we live, the necessity to regulate every single aspect of our public and private life, the unnecessary intrusion of government in citizens' lives, the judicialization of every problem that citizens have and, on the other hand, the alternatives to this reality in the context of insurance fraud are going to be the main theme of the following section.

The over-regulation by the State is a worldwide phenomenon at least in the western democracies, where State intervention often appears as a solution to all social problems. Pressure for more laws comes "both from liberals advocating more state regulation and redistribution and from conservatives eager to criminalize or curtail private conduct of which they disapprove."[215] As James Scott, quoted by Schuck, has recently chronicled, " all democratic governments exhibit a chronic need to render their societies "legible" so that they can raise taxes, wage war, design and renew cities, control natural environments, reform agricultural practices, and implement other ambitious schemes for social change."[216] Even though there is limited scientific evidence to test the results and achievements of law, for as

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[214] "Law" is an Anglo-Saxon expression which refers to the customary system. It is a great coincidence that what I am proposing to limit, the criminal law, had, almost 1.000 years ago, a meaning that in certain way I am claiming today.

[215] P. Schuck, *The Limits of Law - Essays on Democratic Governance*, (Colorado, Westview Press, 2000) at 420.

[216] Schuck, *supra* note 224 at 421.

Schuck says "law, after all, takes protean forms and pursues diverse and often incommensurable goals in myriad contexts" that are impossible to measure in terms of the real effect, positive or negative, on society. However, less, in terms of repression, is always better than more, not just in terms of law but in a variety of disciplines that study social behaviour, such as psychology, sociology, or even medicine. Those who advocate more laws should want to know, as Shrunk says, how much law disappoints us, how that disappointment is problematic, how a legal experience is most of the time traumatic and problematic for one of the parties, and how it usually aggravates the problem more and makes simple things into such terrible problems.

The use of the criminal justice system in controlling insurance fraud is a totally disproportionate reaction that only wastes time, problematizes the issue even more, stigmatizes charged people unfairly, and contributes, as already mentioned, to diminishing the law's performance and reputation:

> Only by realistically assessing law's capacities can we preserve its genuine contributions to the social progress while minimizing future policy failures. Paradoxically, a more critical, refined appreciation of these limits might actually increase public support for those reforms that law can successfully implement.[217]

As many sociologists and legal scholars have indicated, the law's greatest limitation is based on its inability to shape effectively the behaviour resulting from rapid and shifting social conditions: "Whereas social change accelerates geometrically, law's capacity to regulate change effectively increases arithmetically or not at all."[218]

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[217] *Ibid.*

When I first presented the topic of decriminalization of insurance fraud in public at Osgoode Hall in the spring of 2000, the first reaction of the public to my thoughts was expressed in one concrete question: Why is cheating in insurance different from cheating in other contracts? This question was followed by many others such as, Is the insurance contract different from other contracts? Why does insurance fraud as a criminal breach of a contract deserve a different treatment from the same crime committed in another kind of contract? Indeed, insurance fraud is another contract among the world of contracts that regulates relations between individuals. It is indeed a contract no different from the rest in terms of its elements, responsibilities and legal formal and informal controls. That it has elements such as "bona fides" or "utmost good faith" does not affect its nature as a "private contract," subject to the same controls and regulations as any other contract in private law. Why then, if it is a "normal" contract like any other, does it deserve a different treatment when it has been breached or affected by fraud? The answer is precisely that no special treatment must be given to insurance fraud, and its decriminalization, as formulated in this work is as well a proposal that includes, at the end of the day, all contracts in private law when the element of cheating has been found. Our proposal to decriminalize insurance fraud is at the same time a proposal to decriminalize many other conducts that might be considered as private conflicts rather than public ones. I am referring to those that theorically "require" the intervention of the State to protect the rest of the society from the wrongdoer.

However, the problem does not rest only in the attitude of people, a product of the legal system, but in the model of the system itself. In Arthurs' characterization, the problem is a product of the current models of centralized and pluralised legal schemes, and the inclination of our legal system to the former. Our systems, and among them I include not just the common law system but the civil system as well, are centralized systems of law, where law is what the law, lawyers and judges say, and where the rest of society is excluded. Law is then an elaborate system of rules and rituals that just a few people in society have the power to access and understand. Law is, according to this centralized vision, an elitist closed system in which the society in general is confined and dominated. Within this system, any expression of justice that seems to escape the law and established procedures could be described as anarchistic, rebellious or even treasonous.

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[218] Schuck, *ibid* note 224 at 163.

When this expensive and elitist system has tried to expand access to justice and improve its mechanisms, it, itself, has created mechanisms such as conciliation and arbitration, which provide even more evidence of discrimination, where conciliation, for instance, has been created for the poor, and arbitration for the rich.

3. Proposals for a new conflict resolution scheme.

Law was created to deal with phenomena perhaps very different from those it is trying to deal with today, insurance fraud being one of the better examples. The fact that insurance fraud attacks a legal creation, or better, a legal label that names an ancient human practice (insurance), does not mean that the problem of insurance fraud itself must be legal, and therefore law has to regulate it. The fact is that the courts are dealing with insurance and the problems deriving from it, and the State through its judges serves the role of an impartial person who provides justice. This is probably good for preventing private and uncontrollable forms of injustice and perhaps for protecting the weak from the strong in the hypothetical case of a "non-public justice." However, this social access to justice is just a myth if we take into account that it is the rich who hire the best defence, while, meanwhile, the poor have access to justice only through public advocacy.

In the process of decriminalization that is contemplated, in order to facilitate the transition from governmental intervention to non-intervention, some stages maybe required, one of which is called *minimalism*. This stage proposes, not the total and immediate dejudicialization of the system, but a gradual process that includes the use of civil justice in those cases in which the criminal justice is normally in charge. In other words, instead of an abrupt decriminalization, which is impossible, scholars propose a gradual movement from the criminal to the civil apparatus. For those who are worried about the protection of the insured, e.i., due process, in a non-interventionist model, civil justice, a less intrusive system, could regulate conflicts when citizens ask for intervention, or the law imposes it.

As we will see through some examples in the following section, the idea of a pluralistic legal system, in which civil solutions are the main source to solve conflicts, implies that individuals are open minded to accept private forms of justice and the transfer from an intrusive criminal justice system to a mainly civil system of solving conflicts.

3.1. "Conflicts as property"

The conception of ***conflicts as property***, coined by Nils Christie,[219] provides tools to defend the necessity of preserving certain kinds of conflict in the private sphere. In this article, Christie starts with a very clear example of how some tribes in Tanzania treat marital and other civil problems by congregating the community in a house of the parties in making a huge circle involving members of the community until an agreement is reached. In this scheme, people who know the problem are the facilitators of the solution, mainly chosen by the parties involved. This illustrates how certain problems need not be taken away from their own environments at the time of giving a solution. Indeed, a complex and huge problem such as insurance fraud requires more than a chat with the parties. However, the philosophy of the Tanzanian people of preserving the conflict "in-house" serves as a good outline. On the other hand, Christie's analysis makes an important statement about how the civil option, rather than the criminal, gives more possibilities for the intervention of the parties involved in the conflict and seems more fair for the parties in the terms exposed in this method. Society then has the possibility of dealing with problems in an expeditious and participative manner. The State, meanwhile, does not have to start an expensive and time consuming criminal procedure. As Christie states,

> I have not yet made any distinction between civil and criminal conflicts. But it was not by chance that the Tanzania case was a civil one. Full participation in your own conflict presupposes elements of civil law. The key element in a criminal proceeding is that the proceeding is converted from something between the concrete parties into a conflict between one of the parties and the State. So, in a modern criminal trial, two important things have happened. First, the parties are being represented. Secondly, the one party that is

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[219] N. Christie, "Conflicts as Property" (1977) 17 British Journal of Criminology at 1.

> represented by the State, namely the victim, is so thoroughly represented that she or he for most of the proceedings is pushed completely out of the arena, reduced to the triggered-off of the whole thing.[220]

What is society losing as a result of governmental intrusion in the specific case of insurance fraud? If it is true that society in general, as a transcendental individual, is not interested in the prosecution of the conduct as I already explained, or that the State is assuming the whole responsibility of regulating relations and solving conflicts, then is the society itself losing the possibility of learning about the conflict? In other words, might the community of insurers be losing the possibility of learning how to face conflict and to prevent it. Community, Christie says, is made from conflict as much as from cooperation; the capacity to face and solve problems is what gives social relations their sinew. On the other hand, the culture of professionalizing justice "steals the conflict," robbing the community of its ability to face problems and restore peace. Communities lose their confidence, their capacity, their inclination to preserve their own order. They become instead consumers of policies and court "services," with the consequence that they largely cease to be communities.

In terms of conflict itself, the historic tradition has been to remove the problem from the society, and split the parties involved in a way that Nils Christie calls "steal[ing] the conflict." The conflict has been taken from society and treated by a group of experts (the legal community), and finally, convicted, the criminal is isolated in an institution called a prison, ignoring the victim and his kindred. However, acts that have been called crimes by the legislative elite are part of our lives, part of the development of society, and belong to it if we are to progress and learn from them. As Cayley says,

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[220] *Ibid.* at 3.

> The acts that we hold apart from ourselves as "crimes" and attribute to an alien tribe called "criminals" are often the most vividly human of predicaments. They are a unique disclosure of the conflicts and tensions underlying social life, and they may sometimes offer a unique opportunity to resolve these conflicts.[221]

A possible solution to this complex set of difficulties in the criminal justice system is, from my point of view, very clear: the "civilization of the solutions." With this expression authors such as Christie, Hullsman, and Cayley express their discomfort with the criminal law and propose the boundaries of a civil solution, one full of opportunities in terms of developing an understanding between parties, the participation of the offender and the offended in the conflict, its clarification, and the pedagogical function that an open conflict can bring to our society.

Insurance companies, consciously or not, have developed, as explained in Chapter Five, methods that in a good or bad way are trying to deal with insurance fraud by excluding any intervention of the State, or at least to minimize it. The development of these techniques expressed in Expert Systems of Fraud Detection, special laws in the contracts, the creation of investigative departments in the companies in charge of the investigation of claims, conciliation procedures with the insured in cases in which fraud has been discovered, and finally, the cancellation of contracts and the inclusion of the defrauder in what is called "black lists," just to mention some of the private initiatives new to me, have been measures developed on the initiative of insurance companies and insurers that understand that fraud affects them, measures completely apart from any external impositive system. The different procedure that society has given to insurance fraud makes this "offence" different from others such as theft, robbery or even homicide. It is not in this case the nature of the conduct, but above all the volition of the society that counts here. In this case, as with many other social phenomena, the best criteria to define when to intervene, what kind of intervention is best, and where to draw the line and what kind of criteria to use are developing by observing the behaviour and signals of the society itself. Nothing can replace social observation and the volition of society.

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[221] *Ibid.*

With respect to the legal approach, for every single conduct that appears in the Criminal Code the debate has been framed in the possibilities of give *more punishment, some punishment* or *no punishment* to the conduct under analysis. Depending on the social context of the conduct, its real potential to harm the society and some other considerations, the legislator decides which kind of control has to be given to the conduct. Furthermore, this range of possibilities of control is always influenced by the government and its inclinations of a liberal, conservative or neo-liberal form of government.[222]

3.2. Abolitionism and radical non-intervention as a sociological theories of a new approach.

Theoretical support for the subtraction of insurance fraud from the criminal justice system realm.

The works realized by Hullsman, Bernart de Celis, Nils Christie and Mathiesen among others, could be summarized in a general theory of abolition of the criminal justice system with the purpose of getting a rich and better system of social control based on equality and the abolition of incarceration as a system of humiliation and suffering.[223]

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[222] F. Tocora, *La Politica Criminal en America* (The Political economic of crime in America), (Bogota: Temis Editores, 1992).

In their basic premises they recognize the vast gap between the theoretical goals of the criminal system, and specially the deprivation of liberty, and the results of the incarceration as a "gold gun" of the penal system. According to Bernardt de Celis, there is a general recognition, that I also share, of the failure of the prison as "so-called reparation for the harm done by the crime…,"[224] and the premises of resocialization. The penal system does not provide any compensation to the victims of the crime, and, on the other hand, the prisons are more schools of crime where the victims of the system come out worse than when they went in.

For Hulsman and Celis[225] the basis of the criticism of the penal system can be listed as follows: the penal system takes the conflict out of the hands of the social instances directly involved, the penal system's goal is to inflict suffering and, finally, the suffering inflicted by the penal system is "unequally distributed."

For the analysis of insurance fraud and our proposal of removing it out of the criminal justice system, these former reflections are very valuable and remit us to the following reflections:

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[223] The theory of penal abolitionism vary from the radical non-intervention or radical abolitionism to the minimalism. This latter theory presents the use of the penal system just for major crimes, trying to abolish the criminal justice system in those cases where its results are worst than the crime itself.

[224] B.J. De Celis, "Alternatives to the Criminal Justice System, An Abolitionist Perspective - Conversations with Louk Hullsman," (Montreal: University of Montreal - International Centre for Comparative Criminology, 1986) at 13.

[225] *Ibid.* at 23

1. The penal system takes the conflict of insurance fraud out of the hands of the persons directly involved, in this case, the insurance companies. Therefore, the consequences of this are the theoretical trust of the insurance companies in the solutions that criminal system could provide, and the reliance on that system as the only and effective solution to the problem, both false pretences in any sense. All the power for the insurance companies to solve conflict is stopped, and the creation of better solutions, more according to the reality of the problem, is frustrated. Fortunately, this situation in North America is quite the opposite. The insurance industry since the middle seventies is taking on its own the control of the problem, using the criminal justice system just in special cases where the external intervention of the state is irrefutable.

2. The suffering inflicted by the penal system through the prison is absolutely unnecessary especially in the precise event of insurance fraud. Is there any relationship between the crime of fraud, the monetary deprivation caused by the wrongdoer to the victim, to the destruction of a family and the annulation of a human being using the imprisonment system with all its terrible consequences? Certainly not.

3. Following the idea of the authors aforementioned in the point that "the suffering created by the penal system is unequally distributed,"[226] it is important to say that, in relation to insurance fraud, the role of stereotypes and forecasts created by the penal system in relation with delinquents (the labelling approach created by the theory of white collar crime that believes that just the rich people can commit fraud), is carrying bad consequences in the focus of efforts of combatting the insurance fraud. In other words, the labelling approach is

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[226] *Ibid.* at 27

guiding the fraud fighters to a wrong place.

One of the most severe critiques of the abolitionist theory is the contradiction between the postulates of liberty, equality, fraternity and solidarity of our democracies, and the intervention of the penal system in the people's live that carries all sort of humiliations and diminishes of the basic postulates aforementioned.

The criminal justice system, in our personal view, has to be maintained just as an ***ultima ratio***; that is, just in cases when the other possible resources to solve the conflict have been used. In these cases, where the judicial *civil* solutions did not work as well, then the criminal justice system has to serve as a *subsidiary* resource for coping with socially undesirable situations. However, for insurance fraud it is difficult to imagine a situation with the direct solution of the conflict or the civil judicial instance cannot solve the problem.

Another important reflection that scholars do in relation with the maintenance of the criminal justice system in the society is that the function of general prevention and the expectation of the general public (public deterrence) in relation with the system and its severity is a basic reason to maintain it. Again, for insurance fraud, the public deterrence function of the system is more than denied when the problem is growing at an incredible speed, and the probability of being caught in the commission of the action is very low. Therefore, the general prevention in the hands of the private companies could better accomplish the expectation of prevention and deterrence, public prevention campaigns, educational programs among the insured. The examples of real sanctions such as the ostracism of the defrauder from the insurance industry, the cancellation of the policy or even the pecuniary sanctions are more adequate than the poor effects of the penal system.

As Hullsman stated:

> In general, people have very little knowledge about the laws procedures or penal sanctions. This simple fact seriously weakens one of the foundations of general prevention... We have very little data on the effect of the normative moral education ascribed to the criminal law, too often confused with the effect of intimidation. Furthermore, researchers are not completely in agreement as to whether or not this educational effect could perhaps be greater than the mere fear of being discovered and punished; would people abstain from committing crimes because the criminal law would represent a kind of collective awareness of good and bad that they would have internalized?[227]

The criminal abolitionist theory offers us a comprehensive model to analyze the problem of fraud control by the insurance industry. The technique used by insurance companies corresponds to a form of social control different from the traditional criminal system:[228] the treatment of deviation without the intervention of the state. It supposes, at the end of the day, that the criminal problem has to be treated in private terms rather than public ones. In other words, the problem is reduced to a civil one between the fraudulent insured and the defrauded insurer. In this case, the insurance company identifies the specific conduct that harms its interests and, through a procedure framed into a social control, tries to obtain compensation for the damage. For the abolitionist theory, this model has advantages in that it is the society that is regulating the conflict, and the results of the sanction are better than the illegitimate sanction of prison.[229] In this case, our new model, as a technique that follows in part the scheme of the criminal law, is now looking for a different goal in comparison to the traditional model of the criminal law. Szabo terms it intimidation or dissuasion, elimination or neutralization, reform or punishment.[230]

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[227] *Ibid.* at 4

[228] Ferrajoli, *supra* note 161, at 251 – 252.

[229] The concept of ***illegitimate sanction of prison*** is an essential part of the abolitionist theory , crucial in this thesis. The concepts of "alternative to prison" and "alternatives to the criminal justice system" have been very popular in the last ten years or so. In Canada, the concept of "diversion" was first popularised by the Law Reform Commission (1975). In the United States, the idea went from

For us, the new model does not share with the criminal justice system the idea of a social unity. The criminal law, as a private technique, attempts to solve a conflict in private terms, bringing welfare in a reduced social space. However, we are not sure about the equity correspondence between the *offence* and the *punishment* proposed for the new model (cancellation of the policy, denial of the claim, ostracism and black lists). The issue of ***retribution*** has to be restated in light of the new proposal.

This understanding of the problem takes us to a question already asked: What are the limits of this punitive power? Actually, these limits cannot be given in the same terms as the guarantee theory,[231] since the function of social control is not bound to the constitutional principles of one country or international treaties. The internal legitimacy of the model can

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"diversion" to "neighbourhood justice"(Tomasic and Feeley , 1982) and a "politics of informal justice"(Abel, 1982). In Europe, ideas about the "abolition" (partial or extensive) either of prison or of the criminal justice system were developed by and from the works of Norwegian sociologists Thomas Mathiesen (*The Politics of Abolition*, 1974) and Niels Christie (*Limits to Pain*, 1981) , the French philosopher Michel Foucault (*Surveiller et punir*, 1975), The Council of Europe (*Report on Decriminalization*, 1980), and Dutch jurist and criminologist Louk Hulsman (Peines perdues, 1982), among others. See Celis Jaqueline Bernart de, *Alternative to the criminal justice system : an abolitionism perspective*, International Centre for Comparative Criminology (Unversite de Montreal, 1986) at 12.
See T. Mathieseen, *The Politics of Abolition*, Scandinavian Studies in Criminology (4) (New York: Jhon Wiley & Sons, 1974) at 83.
C.R. Dodge, *A World Without Prison*, (Toronto: Lexington Books, 1979) at 20-37.

[230] D. Szabó, *Criminology and Crime Policy*, (Toronto: Lexington Books, 1978) at 160.

[231] The guarantee theory is based on the principles of rights and civil guarantees and is an essential condition for political theories in most of the liberal countries framed into the rule of law. Some relevant authors are:C. Schmitt , *Teoría de la Constitución (Constitutional Theory)*, (Madrid: Alianza Editorial,1987) ; G. Jakobs, *Derecho Penal Contemporáneo (Contemporary Criminal Law)*, (Madrid: Ariel Editores, 1993.)

be traced in terms that demonstrate the dangerous existence of a model for administering justice that is not formally recognized, that proposes, at the same time, remedies and controls for the new practice. At this point, we have to accept that the abolitionist theory is insufficient to justify the model, and it is necessary that the social control itself, in any of its expressions, must be formalized to be controlled. What the factual model of operation against fraud that the insurance companies use today demonstrates is the possibility of reaching an agreement about the criminal conflict. However, the problem that persists in its nature as a conflict solver is not yet dealt with.

What I have tried to do with the application of the abolitionist theory is to demonstrate how the treatment of fraud among insurance companies corresponds to a model of social control. However, this model is uncontrollable since its nature and legitimacy are not yet recognized and its lack of recognition could threaten civil and social rights.

In order to finish the analysis in the light of the abolitionist theories, we have to say then that the criminal justice system is not the place to solve insurance fraud. Paraphrasing Bernardt de Celis, all behaviour considered undesirable should be seen as the manifestation of a "problem solution," and when we seek to stop it, we must locate the problem in the interpersonal, cultural and socio-political environment that caused it if we want to find an adequate type of intervention. When the outside intervention seems inevitable (the criminal justice system), there is always the resource of the person's natural social groups acting as conciliators, with the parties involved coming face to face whenever possible.

In the absence of social mediators, or natural instances of solving the problem like, in the case of insurance fraud the insurance companies themselves, or the institutions created by them to deal with the problem, or in the case where they have failed, the intervention of the state has to be in the form of civil remedies. In all cases, " the intervention of third parties should be strictly limited to the wishes of the persons directly involved, and excluding any imposition of "gratuitous suffering."[232]

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[232] Celis, *supra* note 233 at 12

Conclusions

A new understanding.

What we have seen in previous chapters are basically the legal responses to the phenomenon from different legislation, as well as the "extra legal" response from the private industry. In relation to the legal responses we have two types, the criminal and the civil. In regarding the civil response, the response is remarkably consistent across the three jurisdictions analysed. However, in relation to the criminal approach, there are substantial variations of the problem, from the non-formal legal consideration in England, to the specific legal treatment in the United States, with Canada in an intermediate position. What – despite variation– do criminal responses share? In a nutshell, the answer is: state appropriation of the problem, with the analysed disastrous consequences for the industry. In brief, what we can conclude about the effectiveness of the criminal law in insurance fraud cases is the little effectiveness, its high statistics around the world, just few cases in the courts and the insurers motivated not to use it. On the other hand, what we can conclude about the effectiveness of civil law in insurance fraud cases it is that is indeed more effective to deal with, and that there are a great number of cases in the courts. What seems to be the preferred means for insurers to deal with fraud is then the extra-legal option. And what makes this approach appealing is, among others, the fact that they can control the information about the problem, control processes of detection and prevention as well as punishment. In other words, they have the control over the remedy. What we see in the insurance companie's response is a model for a non-criminal response to a conduct that is currently criminalized.

The prevalence of insurance fraud is overwhelming and is growing daily throughout the world, and the insurance industry is continually developing new schemes to control the problem. What is interesting about these schemes is that the majority exclude the intervention of the criminal justice system and even the justice system in general (including the civil option) in their solutions to the problem. All the difficulties that we have already analysed in this thesis in relation to the criminal and civil treatment of the problem are understood by the insurers. They know that the judicial solution has been, since its early origins, badly designed and inappropriate. Therefore, the insurance industry around the world is taking the problem into its hands and trying to design programs and methods to prevent and detect the problem and to solve it through solutions provided by the insurance contract itself or through direct negotiation with the insured.

However, what is behind this movement is a change in the paradigm[233] of who has to deal with the conflict and a change in the perception of how far the state can go. The academic trend toward decriminalisation is quite strong in countries such as Norway, Denmark, Holland and Italy, and is becoming stronger in the United States and in Canada, especially in the province of Quebec. The basic aim of trends such as the penal abolitionism and the penal minimalism is a reduction in the use of the criminal justice system. In fact, the theory of the fundamental rights and the civil rights which are the basis of these trends considers the criminal law the exception for those cases in which its application is absolutely essential. The question beyond these postulates is simple, "Is the penal system good?" A comparison between the results expected of the penal system and what it actually produces makes an overall judgment possible.

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[233] Paradigm in the sense of changing of schemes and believes of understanding. Paradigm in the sense that Thomas S. Kuhn gave to the word. *See* T.S. Kuhn, *The Structure of the Scientific Revolutions* (Chicago: The University of Chicago Press, 1962) at 33.

The results obtained by incarceration in comparison with the theoretical goals of the deprivation of liberty are obvious. There is a general recognition that the result of this comparison is always negative and that there is no justification to continue with the penal scheme considering its poor consequences in the society in terms of public deterrence, one of its principal goals.

Insurance fraud seems to be treated in the wrong way when it looks to the criminal justice system for solutions. The civil remedies, even though they are not very often used by the industry, seem to be more adequate as solutions in those cases where the judicial approach has to be used.

Some insurance fraud experts have been presenting the actual situation of the problem as an example of how penal abolition is in fact a reality in the field of insurance fraud. Authors such as Jean Luc-Bahcer[234] show how Canada and Switzerland are examples of how the private insurance companies are freely organising the fraud prevention politics and the treatment of the problem when it is detected without using the criminal law in these solutions. The recognition of private institutions such as the Canadian Coalition Against Insurance Fraud, the Coalition Against Insurance Fraud in the United States and the Crime and Fraud Prevention Bureau in England, among others, is an example of how for one specific problem that is concurrently treated by the criminal justice, private industry is creating a whole scheme of control excluding governmental involvement.[235]

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[234] Bacher, *supra* note 91, at 33.

In a world dominated by local and global politics of domination, control, subordination to the authority, and intervention of the state in every single aspect of the daily life of the individual, proposals for total or partial decriminalization are not very well received. Despite the efforts that scholars and theoreticians from the social sciences have made to expand and promote the culture of non-intervention and self control with respect to conflicts among citizens, the world wide tendency is to criminalize, to over control, and to intervene in social relations. However, this thesis distances itself from this problem, the problem of ploughing the sea. This thesis finds a correspondence in the reality of the physical world. It is not a proposal based on theoretical facts, on academic thoughts. The purpose of this thesis has been, among other things, to argue for the control of insurance fraud by the private sector and to describe the failure of the criminal justice system in dealing with it. Through observation of the social phenomenon I, as a lawyer, have tried to contextualize the role of the law in such a circumstance and to redefine its level of intervention, if any, in relation to this behavior. My proposal then, is more than a rhetorical discourse, its intent is to describe in black and white an overwhelming reality. My intent and conviction has been to find solutions to some specific social problems within the environment in which they are produced, giving to the actors in the conflict the role of problem solvers. This position shares in some way the thoughts of the anarchists of the first half of the twenty century in the sense that law and government should be merely instruments of regulation for non legitimate intervention. It is in this sense that criminal law, an instrument of power and oppression, is valid for many situations, but indeed not for purely "civil" conflicts such as insurance fraud. This thesis intends to speak from the other bank of the river; does not prove anything; it only states.

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[235] The self-regulation option, successful in the segment of security industry, that "permits persons or companies... to conduct their business more efficiently and profitably, either through an exchange of information or through the improved public relations which a formal association with perhaps a permanent staff who can control desirable conducts..." (*supra,* note 20 at 386) is a very interesting possibility to be explored in the topic of insurance fraud.

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